

PERFORMANCE AUDIT
OF THE
BUREAU OF LOCAL GOVERNMENT SERVICES

DEPARTMENT OF TREASURY

February 2004

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:
<http://www.state.mi.us/audgen/>



Michigan Office of the Auditor General REPORT SUMMARY

Performance Audit

Bureau of Local Government Services

Department of Treasury

Report Number:
27-290-02

Released:
February 2004

The Bureau of Local Government Services provides various services to local units of government, including assisting the State Tax Commission in supervising the administration of State property tax laws; administering the State's delinquent property tax reversion process; auditing and overseeing the accounting and audits of local government; monitoring and approving local unit deficit elimination plans; and reviewing applications for the issuance of debt. Certain findings included in this report specifically relate to activities occurring within the local units of government. Because the Bureau may not be directly responsible for these functions, we have addressed these findings and related recommendations to the Department rather than the Bureau.

Audit Objective:

To assess the Bureau of Local Government Services' effectiveness in administering the functions of the Department of Treasury's local government services.

Conclusion:

We concluded that the Bureau was not effective in administering the functions of the Department's local government services. We noted 11 findings, including 10 we consider material related to collection of the industrial facility tax, collection of State tax revenues held by a city, accounting for the industrial facility tax, audit of the industrial facility tax, collection of the State education tax (SET) and real estate transfer tax (RETT), accounting for SET and RETT, collection and oversight of property tax revenue from tax increment financing, collection of specific taxes, collection of interest on untimely remittance of State taxes, and annual audits of county government (Findings 1 through 7 and 9 through 11).

Although our audit procedures were not designed to detect all uncollected tax revenue, these findings disclose uncollected State tax revenues and estimated additional tax revenues in the following amounts:

Uncollected State Tax

Revenues:

Industrial Facility Tax	\$ 67,000,000
Tax Increment Financing	<u>15,800,000</u>
Total	<u>\$ 82,800,000</u>

Estimated Additional Tax

Revenues:

Trailer Coach Park Tax	\$ 3,500,000
Interest	<u>32,600,000</u>
Total	<u>\$ 36,100,000</u>

Grand Total \$118,900,000

~ ~ ~ ~ ~

Audit Objective:

To assess the Local Property Services Section's effectiveness and efficiency in

administering the delinquent property tax reversion process and the Special Assessment Deferment Fund.

Conclusion:

We concluded that the Local Property Services Section was not effective and efficient in administering the delinquent property tax reversion process and the Special Assessment Deferment Fund. We noted 8 findings, including 4 we consider material related to the Delinquent Property Tax Administration Fund, revenue and accounts receivable reconciliations, accounting for delinquent property tax revenue, and Special Assessment Deferment Fund accounting (Findings 12 through 14 and 16).

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Audit Objective:

To assess the Local Audit and Finance Division's effectiveness and efficiency related to reviewing and conducting audits of local units of government.

Conclusion:

We concluded that the Local Audit and Finance Division was not effective and efficient in reviewing and conducting audits of local units of government. We noted 7 findings, including 2 we consider material related to oversight of local units of government and performance audits of State transportation funds (Findings 20 and 21).

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Audit Objective:

To assess the Property Tax Division's effectiveness and efficiency in administering the functions of the property tax program and the training and certification of assessors.

Conclusion:

We concluded that the Property Tax Division was generally effective and efficient in administering the functions of the Property Tax Division and the training and certification of assessors. However, we noted 3 findings, which we consider reportable conditions.

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Agency Response:

The Department's response indicated agreement with 25 findings (Findings 1, 3 through 10, 12, 14 through 27, and 29). The Department's response indicated disagreement with 4 findings related to administration of local government services (Findings 2 and 11), administration of delinquent property taxes (Finding 13), and administration of property tax (Finding 28).

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

February 4, 2004

Mr. Jay B. Rising
State Treasurer
Treasury Building
Lansing, Michigan

Dear Mr. Rising:

This is our report on the performance audit of the Bureau of Local Government Services, Department of Treasury.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

This page left intentionally blank.

TABLE OF CONTENTS

BUREAU OF LOCAL GOVERNMENT SERVICES DEPARTMENT OF TREASURY

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
Description of Agency	7
Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up	8
COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES	
Administration of Local Government Services	11
1. Collection of the Industrial Facility Tax	11
2. Collection of State Tax Revenues Held by a City	15
3. Accounting for the Industrial Facility Tax	17
4. Audit of the Industrial Facility Tax	19
5. Collection of SET and RETT	22
6. Accounting for SET and RETT	25
7. Collection and Oversight of Property Tax Revenue From Tax Increment Financing	28
8. Collection and Administration of the Trailer Coach Park Tax	29
9. Collection of Specific Taxes	32
10. Collection of Interest on Untimely Remittance of State Taxes	34
11. Annual Audits of County Government	37
Administration of Delinquent Property Taxes and the Special Assessment Deferment Fund	39
12. Delinquent Property Tax Administration Fund	39

13. Revenue and Accounts Receivable Reconciliations	42
14. Accounting for Delinquent Property Tax Revenue	45
15. Recovery and Recording of Tax Lien Sales Cancellations	47
16. Special Assessment Deferment Fund Accounting	49
17. Special Assessment Deferment Fund Verification Notices	52
18. Special Assessment Deferment Fund Accounts Receivable and Interest Receivable	53
19. Continuous Quality Initiatives	54
Review and Audits of Local Units of Government	57
20. Oversight of Local Units of Government	58
21. Performance Audits of State Transportation Funds	62
22. Fraud Inquiries and Complaints	63
23. Filing of Required Reports and Notifications	64
24. Updating of Local Unit Accounting and Auditing Guidance	66
25. Chargeback Audit Billing Rates and Cost Recovery	67
26. Receipt of Municipal Finance Filing Fees	69
Administration of Property Tax	70
27. Oversight of County Equalization	71
28. Personal Property Assessments	74
29. State Assessors Board Revenue	77

GLOSSARY

Glossary of Acronyms and Terms	80
--------------------------------	----

Description of Agency

The Bureau of Local Government Services, Department of Treasury, provides various services to local units of government through three divisions and one section:

1. Property Tax Division

The Property Tax Division provides staff support to the State Tax Commission, which consists of three members who are appointed by the Governor. The functions of the State Tax Commission include supervising the administration of State property tax laws, supervising the local assessors and county equalization directors, equalizing property assessments, certifying various tax rates, and administering tax exemption certificates. Also, the Property Tax Division monitors commercial and industrial facility tax* collections.

2. Assessor Certification Division

The Assessor Certification Division provides staff support to the State Assessors Board, which consists of five members appointed by the Governor. The Board approves and conducts training courses and administers examinations for assessing officers.

3. Local Property Services Section

The Local Property Services Section administers the State's delinquent property tax reversion* process and administers the Special Assessment Deferment Fund*.

4. Local Audit and Finance Division

The Local Audit and Finance Division reviews audits received, conducts audits, monitors the financial condition, and performs investigations of counties and other local units of government. The Division maintains a uniform chart of accounts and reporting requirements for local units of government. Also, the Division monitors audits of pari-mutuel wagering* at horse racetracks throughout the State, monitors and approves local unit deficit elimination plans, and reviews applications for the issuance of debt.

The Bureau had 55 employees as of March 1, 2003 and expended approximately \$9 million in fiscal year 2001-02.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Bureau of Local Government Services, Department of Treasury, had the following objectives:

1. To assess the Bureau's effectiveness* in administering the functions of the Department's local government services.
2. To assess the Local Property Services Section's effectiveness and efficiency* in administering the delinquent property tax reversion process and the Special Assessment Deferment Fund.
3. To assess the Local Audit and Finance Division's effectiveness and efficiency related to reviewing and conducting audits of local units of government.
4. To assess the Property Tax Division's effectiveness and efficiency in administering the functions of the property tax program and the training and certification of assessors.

Audit Scope

Our audit scope was to examine the program and other records of the Bureau of Local Government Services. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Certain findings included in this performance audit report specifically relate to activities occurring within the local units of government. Because the Bureau may not be directly responsible for these functions, we have addressed these findings and related recommendations to the Department rather than the Bureau for corrective action, consistent with the State Treasurer's responsibility to accept payment and account for certain State property tax revenues received from the local units, the State Tax

* See glossary at end of report for definition.

Commission's responsibility to exercise general supervision over the assessing officers of the State and to take such measures as necessary to secure the enforcement of the provisions of the General Property Tax Act*, and the Department's role in carrying out these responsibilities.

Audit Methodology

Our methodology included examination of the Bureau's operations and records primarily for the period October 2000 through February 2003. Our fieldwork was performed primarily from January 2002 through April 2003.

To assess the effectiveness of the Bureau's administration of local government services, we examined procedures and records related to the State's property tax and local government audit processes.

To assess the effectiveness and efficiency of the Local Property Services Section, we analyzed the Section's procedures for delinquent property tax reversions and special assessment deferments. Also, we tested purchases, redemptions*, refunds, and other records related to administering delinquent property tax reversions. In addition, we analyzed and tested loans and other records related to the Special Assessment Deferment Fund.

To assess the effectiveness and efficiency of the Local Audit and Finance Division, we analyzed the Division's procedures and examined records related to audits of counties and local units of government. We reviewed audit reports of local units of government completed by public accounting firms and applications received from municipalities to borrow funds. Also, we examined the Division's audit procedures and working paper review of public accounting firms that performed pari-mutuel audits.

To assess the effectiveness and efficiency of the Property Tax Division, we examined the Division's procedures and records related to establishing the annual State equalized valuations for each county in the State and supervising the general property tax laws. Also, we reviewed and assessed procedures and controls used by the Division to assess valuations of public utilities. In addition, we tested the certification levels of local assessors and county equalization directors for compliance with State laws.

* See glossary at end of report for definition.

Agency Responses and Prior Audit Follow-Up

The Department's response indicated agreement with 25 findings (Findings 1, 3 through 10, 12, 14 through 27, and 29). The Department's response indicated disagreement with 4 findings related to administration of local government services (Findings 2 and 11), administration of delinquent property taxes (Finding 13), and administration of property tax (Finding 28).

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Treasury to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Department had complied with 4 of the 17 prior audit recommendations included within the scope of our current audit. Seven of the prior audit recommendations are repeated in this report, 1 was not repeated, and 5 were rewritten for inclusion in this report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

ADMINISTRATION OF LOCAL GOVERNMENT SERVICES

COMMENT

Audit Objective: To assess the Bureau of Local Government Services' effectiveness in administering the functions of the Department of Treasury's local government services.

Conclusion: We concluded that the Bureau was not effective in administering the functions of the Department's local government services. Our audit disclosed 10 material conditions* related to collection of the industrial facility tax, collection of State tax revenues held by a city, accounting for the industrial facility tax, audit of the industrial facility tax, collection of the State education tax* (SET) and real estate transfer tax* (RETT), accounting for SET and RETT, collection and oversight of property tax revenue from tax increment financing*, collection of specific taxes, collection of interest on untimely remittance of State taxes, and annual audits of county government (Findings 1 through 7 and 9 through 11). Our audit also disclosed a reportable condition* related to collection and administration of the trailer coach park tax* (Finding 8).

FINDING

1. Collection of the Industrial Facility Tax

The Bureau had not established procedures to ensure that local unit treasurers collect and remit to the Department the industrial facility tax that they receive from taxpayers on behalf of the State.

* See glossary at end of report for definition.

Our review of the payment remittance and collection processes for the industrial facility tax disclosed the following deficiencies:

- a. The Bureau did not verify industrial facility tax payment documentation for completeness and accuracy. Industrial facility tax payments are processed and recorded by the Department's Receipts Processing Division, which forwards related payment documentation to the Bureau's Exemption Programs Section without further review.

Our review of the payment history of 33 local units of government disclosed \$67.0 million in industrial facility tax that 24 local unit treasurers collectively had not remitted to the State.

- b. The Bureau did not maintain a record of which local unit treasurers had not remitted industrial facility taxes to the State as required by law.

Our review of 2001 industrial facility tax payments disclosed that the State had not received payment from local unit treasurers for 150 (29%) of the 519 local units of government with active industrial facilities tax exemption certificates.

- c. The Bureau had not determined how much industrial facility tax revenue was expected from the various local units of government that possessed active industrial facilities tax exemption certificates, nor had the Bureau sent related tax bills to the respective local units of government. Instead, the Bureau relied on the individual local units of government and their treasurers to determine and remit payment to the State for the industrial facility tax that they collected.
- d. The Bureau's newly developed system of self-reporting industrial facility tax information for local units of government was ineffective in collecting reliable information:

- (1) Local unit treasurers failed to complete and submit the industrial facility tax reporting form upon the Bureau's request. The Bureau required local unit treasurers to submit their industrial facility tax reporting forms annually with their winter tax payments. However, as described in item b., treasurers of 150 local units of government with active industrial facilities tax exemption certificates did not submit payment or the accompanying form.

- (2) The Bureau did not verify the accuracy of the industrial facility tax reporting forms submitted by local unit treasurers, notably the number of active industrial facilities tax exemption certificates issued for the local unit and the taxable values or millage rates reported. The latter are especially important because some local units of government have multiple school districts with different millage rates within their jurisdiction, which requires separate industrial facility tax calculations for each certificate based on location.
- (3) The Bureau did not require local unit treasurers to submit supporting documentation related to industrial facility tax revenues that were "captured*" under tax increment financing. This is particularly important because the Bureau had suspended efforts to audit and collect excessive capture of taxes, which includes State taxes such as the industrial facility tax that would otherwise be paid to the State. The Bureau's practices allow local units to capture any or all of the industrial facility tax payments that would otherwise be made to the School Aid Fund*, without providing any supporting documentation to substantiate the propriety of the capture.
- (4) The Bureau's method of self-reporting was not effective. Some local unit treasurers have experienced difficulties in completing the Bureau's industrial facility tax reporting form, which has required extensive assistance, inquiries, and communications between Bureau staff and the local unit treasurers. If the Bureau completed the industrial facility tax reporting forms as a statement of account, this would allow the Department, rather than the local unit treasurers, to independently and uniformly establish the amount of tax due the State.

Sections 207.551 - 207.572 of the *Michigan Compiled Laws* allow certain local units of government the ability to offer property tax incentives to encourage restoration or replacement of obsolete industrial facilities. The incentives exempt qualified property from ad valorem* real and personal property taxes for a period of up to 12 years. In lieu of the ad valorem property tax, a specific tax known as the "industrial facility tax" is levied. A replacement industrial facility is taxed at the full

* See glossary at end of report for definition.

millage rate for the taxable value of the real and personal property of the facility for the tax year prior to the exemption. A new industrial facility is taxed at one-half the millage rate otherwise applied, based on the current assessed property values of the new facility. Section 207.561 of the *Michigan Compiled Laws* requires local units of government to remit the industrial facility tax to the State Treasury to the credit of the School Aid Fund.

As of December 2001, there was a total of 3,879 active industrial facilities tax exemption certificates in 519 local units of government. The Department received \$154.1 million and \$131.7 million in industrial facility tax revenue in fiscal years 2001-02 and 2000-01, respectively.

Establishing procedures to ensure that local units of government remit, through their treasurers, the industrial facility tax due the State would help alleviate significant shortfalls in industrial facility tax collections. Collection of the industrial facility tax as required by law positively impacts the School Aid Fund, as well as the General Fund, from which appropriations may be required to supplement State school aid funding shortfalls under the State's school aid distribution formula.

A similar condition was reported in our prior audit report, which identified \$15.5 million in uncollected industrial facility tax from just four local units of government. Although the Department agreed with our prior audit recommendation, it has not complied.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE BUREAU ESTABLISH PROCEDURES TO ENSURE THAT LOCAL UNIT TREASURERS COLLECT AND REMIT TO THE DEPARTMENT THE INDUSTRIAL FACILITY TAX THAT THEY RECEIVE FROM TAXPAYERS ON BEHALF OF THE STATE.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the recommendation and will seek legislative and information technology tools to enable it better to monitor collections at the local level and remittance of collected taxes to the State on a timely basis.

FINDING

2. Collection of State Tax Revenues Held by a City

The Department granted the City of Flint relief from timely payment of \$22.9 million in State tax funds and negotiated an interest-free payment plan with the City for \$12.0 million of the \$22.9 million without the statutory authority to do so.

The City Treasurer did not remit to the State industrial facility and commercial facilities tax revenues that the City received from taxpayers on behalf of the State for the following tax years in the following amounts:

<u>Tax Year</u>	<u>Amount (a)</u>
1986	\$ 1,310,873
1987	1,770,893
1989	2,805,830
1990	2,908,950
1991	3,189,180
1992 (b)	1,506,629
1993 (b)	1,873,055
1994 (b)	481,000
1995	1,711,578
1996	1,842,397
1997	1,773,131
1998	715,404
1999	600,734
2000	359,347
2001	52,271
Total	<u>\$22,901,272 (c)</u>

- (a) These amounts do not include related interest under Section 211.87 of the *Michigan Compiled Laws*, which is reported in Finding 10.
- (b) Our prior audit of the Bureau in 1996 included \$14.1 million in industrial facility tax that was owed to the State by the City of Flint for tax years 1992 through 1994. These amounts represent the \$3.9 million (28%) of the \$14.1 million in industrial facility tax that the City still owed the State for those tax years.
- (c) This total was included as part of the \$67.0 million described in Finding 1.

The industrial facility tax is assessed upon owners of property issued an industrial facilities tax exemption certificate. The commercial facilities tax is assessed upon owners of property issued a commercial facilities tax exemption certificate. These taxes are to be paid to the local unit of government annually, at the same times, in the same installments, as general property taxes. Sections 207.561 and 207.662 of the *Michigan Compiled Laws* specifically require local units of government to remit the industrial facility and commercial facilities taxes to the State Treasury to the credit of the School Aid Fund.

Instead of remitting the industrial facility and commercial facilities tax revenues collected from taxpayers to the State, the revenues were deposited in the City's pooled cash and investments account. In its January 31, 2002 audit management letter, the City's auditors disclosed that as the City spent more than the available resources from various funds, it borrowed from other funds through its pooled cash account, including the State funds, which are restricted by law. As a result, the City's auditors concluded that ". . . the City has improperly spent restricted resources and does not have the current ability to repay the borrowed monies."

From 1998 through the fiscal year ended June 30, 2001, the City's pooled cash account decreased from \$97.2 million to \$22.9 million. The City informed the Department that it required the continued use of \$22.9 million in State tax funds for "cash flow purposes." However, in its response to the State's recent emergency financial review of the City, the City indicated that it possessed between \$35 and \$40 million in its pooled cash and investments account as of June 30, 2002.

Upon learning in 2001 that the City had failed to remit \$12.0 million in State tax funds to the State for tax years 1986 through 1991, the Department granted the City relief from immediate payment of the State's "borrowed" revenue and negotiated an interest-free payment plan with the City. The payment plan, extending through 2004, requires annual payments of \$4 million beginning in July 2002. In addition, as included in Finding 1, the Department has also not received \$10.9 million in State tax funds from the City for tax years 1992 through 2001.

The Department indicated that the City did not qualify for assistance under the Municipal Finance Act, Emergency Municipal Loan Act, or Fiscal Stabilization Act and that upon discovery of the City's unauthorized use of State funds, the Department undertook the payment plan as the only alternative available to it to

secure eventual repayment of the converted funds. Nevertheless, the Department lacked the authority to unilaterally bind the State to such an arrangement.

RECOMMENDATIONS

We recommend that the Department require the City of Flint to remit timely payments of all State tax revenues that the City has received from taxpayers on the State's behalf.

We also recommend that the Department confine its assistance to local units of government within its statutory authority.

AGENCY PRELIMINARY RESPONSE

The Bureau disagrees that it has the power to charge any interest against the funds of a unit of local government for the failure of the local treasurer to carry out his/her statutory responsibility to remit collected taxes to the State on a timely basis. The Bureau would note that the State has now received \$8.0 million of the originally discovered \$12.0 million of industrial facility taxes erroneously retained by the City Treasurer during the years 1986 through 1991. The Emergency Financial Manager for the City has indicated that the City will pay the remaining \$4.0 million before June 30, 2004. In addition, as a result of continued investigation, the Bureau has determined that, of the \$22.3 million in State industrial facility taxes actually collected by the City Treasurer for the years 1994 through 2000, the amount not remitted to the State (\$7.4 million) was remitted to the Flint Public Schools and the Genesee Intermediate School District. The Bureau will investigate whether the school districts received the appropriate amount of State school aid or an inflated amount as a result of this error by the City Treasurer and work with the Department of Education to correct the matter, if necessary.

FINDING

3. Accounting for the Industrial Facility Tax

The Department's accounting and administrative control system did not include effective controls to account for the receipt of industrial facility tax revenues.

Section 18.1485 of the *Michigan Compiled Laws* requires that State departments, such as the Department of Treasury, establish and maintain accounting and administrative control systems and recordkeeping procedures for revenues.

Our review of the Department's controls to account for the receipt of industrial facility tax revenues disclosed the following weaknesses:

- a. The Department did not maintain accounts receivable records for the industrial facility tax. As a result, the Department could not determine the amount of tax that was due, paid, or still owed from each of the 519 local units of government possessing active industrial facilities tax exemption certificates.
- b. The Department did not reconcile its log of industrial facility tax payments received to the aggregate amount it recorded in the State's accounting records.

The Property Tax Division's Exemption Programs Section maintained a manual log of industrial facility tax payments received from local units of government. Our comparison of the log to the State's accounting system for fiscal year 2001-02 disclosed that the log receipts exceeded the receipts recorded in the State's accounting system by \$14.8 million. We attributed the difference to 19 transactions that were incorrectly entered on the log (\$22.7 million), 17 transactions recorded in the State's accounting system that were missing from the log (\$11.2 million), and 1 transaction contained in the log that was not recorded as industrial facility tax in the State's accounting system (\$3.3 million).

Including effective controls to account for the receipt of industrial facility tax revenues within the Department's system of accounting and administrative control would help the Department in determining whether it is collecting and accurately recording industrial facility taxes received from each local unit of government.

RECOMMENDATION

We recommend that the Department include effective controls within its accounting and administrative control system to account for the receipt of industrial facility tax revenues.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees that it will develop controls to account for the receipt of industrial facility tax revenues.

FINDING

4. Audit of the Industrial Facility Tax

The Bureau had not developed an effective process to audit the industrial facility tax. As a result, a total of \$33.9 million in State tax revenue was never collected.

Our prior audit finding disclosed \$15.7 million in underpayment or nonpayment of the industrial facility tax and commercial facilities tax by 9 of 24 local units of government that we examined in 1995. The Bureau has been conducting an "ongoing study" of industrial facility tax payments since approximately 2001. The Bureau stated that this study was preliminary to developing a process to audit collections of industrial facility tax.

Our review of 10 of 77 local units of government that the Bureau did not audit or study for tax year 1999 disclosed an additional \$32.3 million in industrial facility tax that 6 local units collectively had not remitted to the State. In addition, we noted that the Bureau did not audit or study 23 local units for tax years 1995 through 2000, understated the amount of industrial facility tax due for 1 study by \$710,125, overstated industrial facility tax due for 15 studies by \$890,327, did not identify \$3.1 million in additional industrial facility tax revenue, and did not give 1 local unit credit for \$1.3 million in industrial facility tax paid. (These amounts are included as part of the \$67.0 million described in Finding 1.)

An audit of the industrial facility tax should provide for an examination of applicable records and accounts in order to check the accuracy of the accounting for and collection of the industrial facility tax.

Our review of the Bureau's studies of local unit industrial facility tax payments identified the following deficiencies:

- a. The Bureau did not study 77 of 551 local units of government with active industrial facilities tax exemption certificates.

The Bureau's program for studying industrial facility tax payments required that it study payments made by each local unit for tax year 1999. Our review of 10 of these 77 local units disclosed an additional \$32.3 million in industrial facility tax that was not received by the State for tax years 1995 through 2000. We noted that the \$32.3 amount was associated with only 6 of the local units

and that \$26.5 million of the \$32.3 million was attributed to just 2 of the local units.

- b. The Bureau did not perform additional studies for tax years 1995 through 2000 for 23 local units of government with a 1999 study disclosing variances of at least \$100,000, as required by its program for studying industrial facility tax payments.

The Bureau's program for studying industrial facility tax payments stipulated that when a local unit's 1999 study disclosed a variance of at least \$100,000, further studies for tax years 1995 through 2000 were required. However, the Bureau studied only 33 (59%) of 56 such local units for tax years 1995 through 2000. The Bureau's studies of those 33 local units disclosed \$27.9 million in pending and finalized amounts due.

- c. The Bureau's studies understated the total amount of industrial facility tax owed by some local units of government. For example, our review of 27 of the Bureau's 1999 studies disclosed a study with errors that understated the amount of industrial facility tax owed by \$109,106. In addition, except for 1999, the local unit did not receive a study for the years 1995 through 2000, a period in which our review disclosed an additional \$601,019 in unpaid industrial facility tax. In total, the local unit had \$1.5 million in unpaid industrial facility tax for the six-year period, \$710,125 (47%) of which the Bureau's study did not identify.
- d. The Bureau's studies overstated the amount of industrial facility tax owed by some local units of government. Our sample review of 27 of the Bureau's 1999 studies disclosed 14 studies that had overstated the amount of unpaid industrial facility tax owed by \$622,173.
- e. The Bureau's study procedures did not compare the industrial facilities tax exemption certificates included in the local units' tax calculations to the Bureau's industrial facilities tax exemption certificate database. This procedure would help the Bureau determine whether local units have included all active industrial facilities tax exemption certificates in their tax rolls when calculating the amount of their tax payments.

- f. The Bureau's studies did not use the formula established in its study procedures to calculate the amount of industrial facility tax due.

The Bureau's study procedures required the computation of the amount of industrial facility tax owed, using established formulas of taxable values and millage rates. We reviewed 27 of these studies and found that the computation only re-added the tax contained on the tax rolls prepared by the local units examined. Also, in four instances, we noted that even the re-adding of the tax was not correct, including one case in which misplaced decimals erroneously increased what should have been \$4,957 in tax due to a \$273,111 tax due amount.

- g. The Bureau's study procedures did not verify the amounts used to calculate local unit industrial facility tax payments.

The Bureau requested local unit treasurers to submit a copy of the 1999 industrial facility tax roll used by the treasurers to derive their payments, then used the same figures (e.g., taxable values and millage rates) to "study" local unit payments as were used by the local unit treasurers to calculate their payment amounts. This process did not validate the accuracy and completeness of the figures upon which the local unit tax payments were derived. Instead, the local unit assessors' reports should have been used to calculate the tax due in order to verify the accuracy of the figures used by the treasurers.

Our review of 27 of the Bureau's studies, using local unit assessors' reports to calculate the tax due, identified \$3.1 million in State industrial facility tax revenue that the Bureau's studies did not identify because the studies did not use the proper taxable value and/or millage rate.

- h. In studying the industrial facility tax, the Bureau did not consistently identify the correct amount of industrial facility tax that had been paid to the State by local units of government. For example, in one instance, the Bureau's study had credited the local unit for only \$48 of \$1.3 million of tax paid by the local unit in the Bureau's study calculation of tax due. The Bureau informed us that in several instances, the Bureau had to resort to requesting that local units provide photocopies of canceled checks already received and cashed by the

Department, in its attempt to ascertain how much tax it had received from the local units.

The Bureau cannot effectively audit (or study) the industrial facility tax unless it knows how much tax the local unit has already paid the State.

An effective audit process is critical to establishing and maintaining an appropriate level of accountability over industrial facility tax revenue. However, an effective audit process does not supplant the reforms that are needed in the collection, billing, and accounting of the industrial facility tax (Findings 1 and 3). Implementing an effective industrial facility tax audit process, in tandem with proficient collection, billing, and accounting practices, is essential in establishing an effective means for ensuring that industrial facility taxes are collected and remitted to the State in a timely manner and in the proper amounts by local units of government to the benefit of the School Aid Fund.

RECOMMENDATIONS

We recommend that the Bureau develop an effective process to audit the industrial facility tax.

We also recommend that the Bureau conduct the appropriate audits and collect the amounts outstanding.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and intends to seek necessary legislation to grant it the power to collect from local treasurers, with interest, industrial facility taxes retained or inappropriately remitted to other taxing units.

FINDING

5. Collection of SET and RETT

The Department had not determined whether it had received the correct amount of SET and RETT revenues owed to the State. As a result, the Department lacked assurance that it had received all SET and RETT revenues owed to the State.

The Department received SET revenues of \$1.6 billion and RETT revenues of \$253 million in fiscal year 2001-02 alone. The significant amounts of SET and

RETT received each year establish the necessity of implementing measures to ensure the receipt of all SET and RETT revenues owed the State. In addition, a limited inquiry of RETT by the Department found builders/developers that had underpaid RETT.

Sections 211.901 - 211.906 of the *Michigan Compiled Laws* levy an ad valorem SET on property at a rate of six mills. The SET is collected under the provisions of the General Property Tax Act, which requires local units of government to collect taxes, such as SET, from taxpayers on the State's behalf and to remit the taxes to their respective counties by the tenth day of each month. Section 211.35 of the *Michigan Compiled Laws* requires the Department to prepare and submit a State tax statement to each county showing the amount of State tax revenue, including SET, expected from each county. Section 211.43 of the *Michigan Compiled Laws* requires counties to account for and deliver SET collections on hand to the Department each month.

Sections 207.521 - 207.537 of the *Michigan Compiled Laws* impose a State RETT of \$3.75 for each \$500.00 (or fraction thereof) of the total value of real property transferred by written instruments executed within the State that are either contracts for the sale or exchange of property or deeds or instruments of conveyance of property for consideration. Counties are required to collect RETT and remit it to the Department by the fifteenth day of each month.

Section 211.87 of the *Michigan Compiled Laws* requires the Department to prepare a quarterly statement of account between the State and each county of all money owed and due to each.

The proceeds of both SET and RETT revenues are required by law to be deposited to the credit of the School Aid Fund.

Our review of the SET and RETT collection processes disclosed:

- a. The Department had not established procedures to ensure that it had received all SET revenue.

The Department currently receives approximately \$1.6 billion annually in SET. However, it has never performed an analysis of SET revenue received compared to the amount of SET it should be receiving based on Statewide

taxable property values. As a result, the Department has no benchmark to ascertain whether it is receiving all SET revenue due and payable to the State.

- b. The Department did not prepare a State tax statement for each county showing the amount of SET expected from each county, based on the taxable values assessed in each county, or a quarterly statement of account between the State and each county of SET owed and due to the State.

The Department needs to prepare State tax statements and quarterly statements of account for the counties in order to determine whether the State has received all SET revenue.

- c. The Department did not have a systematic process to verify the accuracy of RETT remittances from the counties and taxpayers. Also, the Department did not pursue collection of tax deficiencies when they were identified.

In response to practices brought to the Department's attention, the Department conducted a limited inquiry of RETT revenue in one county. The inquiry identified three builders/developers that had paid only \$1,155 (24%) of the \$4,913 owed in RETT by paying tax on the price of only the lots sold, but not the homes built upon the lots. The Department did not prepare a quarterly statement of account for the county or otherwise pursue collection of the tax deficiencies identified in the investigation.

The Bureau indicated that it does not interpret its responsibilities to include performing tests or establishing procedures to ensure that SET and RETT revenues are collected and remitted to the State because administration of SET and RETT has been assigned to the Single Business Tax Division. However, the Single Business Tax Division has similarly disclaimed responsibility for ensuring the correct amount of SET and RETT is collected by the State.

RECOMMENDATION

We recommend that the Department ensure that it has received the correct amount of SET and RETT revenues owed to the State.

AGENCY PRELIMINARY RESPONSE

The Bureau respectively points out that the property tax collection system crosses multiple fiscal years at the local level, none of which coincide with the State's fiscal year, thereby causing the type of certainty presumed in the 19th century no longer to be possible in the 21st century. The Bureau therefore agrees to attempt to craft amendments to the General Property Tax Act that reflect the many changes in circumstances that have occurred in the past 100+ years, but believes that implementation of Section 35 of the General Property Tax Act is not achievable in the present day. Further, the Department agrees to develop a program to study the appropriateness of the measure of the base for RETT as interpreted at the local level and to propose legislative corrections, if necessary.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

Although the General Property Tax Act was originally enacted in 1893, Section 35 has been amended several times thereafter by the Legislature, including as recently as December 2002. In addition, other tax collection systems, such as the State's individual income tax, also cross multiple fiscal years which do not coincide with the State's fiscal year.

The SET has been required by law to be collected under the provisions of the General Property Tax Act since its inception in 1994. Using 21st century technology, implementation of the concepts in Section 35 may be achievable by improving the accounting for SET and RETT, described in Finding 6, and using the updated taxable values for SET, which are already being reported to the State by local county treasurers for each tax year.

FINDING

6. Accounting for SET and RETT

The Department needs to improve its accounting for SET and RETT.

Our review of the Department's accounting for SET and RETT disclosed:

- a. The Department did not reconcile SET and RETT cash receipts credited to the School Aid Fund to amounts recorded as paid by the counties in the Department's subsidiary records.

SET receipts credited to the School Aid Fund varied from the amounts recorded as paid by the counties in the Department's subsidiary records over the five-year period we examined:

SET Receipts	Fiscal Year					Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	
Credited to School Aid Fund	\$ 1,236,161,196	\$ 1,243,987,425	\$ 1,335,331,984	\$ 1,428,560,799	\$ 1,574,460,662	\$ 6,818,502,066
Recorded in Department's Subsidiary Records	1,238,686,882	1,241,623,196	1,330,804,550	1,429,397,004	1,565,916,276	6,806,427,909
Difference	\$ (2,525,686)	\$ 2,364,229	\$ 4,527,434	\$ (836,206)	\$ 8,544,386	\$ 12,074,157

Similarly, RETT receipts credited to the School Aid Fund varied from the amounts recorded as paid by the counties in the Department's subsidiary records over the five-year period we examined:

RETT Receipts	Fiscal Year					Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	
Credited to School Aid Fund	\$ 224,431,555	\$ 253,811,142	\$ 250,665,273	\$ 256,133,586	\$ 254,396,666	\$ 1,239,438,223
Recorded in Department's Subsidiary Records	218,463,000	251,862,514	250,606,568	261,351,111	254,861,517	1,237,144,711
Difference	\$ 5,968,555	\$ 1,948,628	\$ 58,705	\$ (5,217,525)	\$ (464,851)	\$ 2,293,512

Reconciling SET and RETT cash receipts helps ensure that the proper amount of revenue is recorded and credited to the School Aid Fund.

- b. The Department had not properly recorded SET revenue in its accounting records.

We obtained SET payment records from Wayne County and Oakland County. Our comparison of the counties' records to the Department's accounting records disclosed that the State recorded \$19.1 million more in SET payments from Wayne County and \$7.6 million less in SET payments from Oakland County than those counties' records indicated that they paid to the State.

- c. The Department did not classify SET and RETT revenues by county in the State's accounting system. Consequently, the Department could not determine how much each county had remitted in SET and RETT payments.

Accounting for the amount of SET and RETT revenues received by each county would help ensure that the appropriate amount of tax is remitted from each county. In addition, such an accounting is necessary to prepare required statements of account between the State and each county.

Sections 211.901 - 211.906 (SET) and 207.521 - 207.537 (RETT) of the *Michigan Compiled Laws* require counties to remit SET and RETT collections to the State Treasurer. Upon receipt, the State Treasurer is required to deposit collections of these taxes to the credit of the School Aid Fund. Section 211.87 of the *Michigan Compiled Laws* also requires the Department to prepare a quarterly statement of account between the State and each county of the amount of State taxes owed and due to the State.

In a 1996 audit of the Department's Single Business Tax Division, we reported similar conditions regarding reconciliation of SET and RETT, including a total of \$12.6 million in SET and RETT revenues that had not been properly credited to the School Aid Fund. Although the Department agreed with the prior audit recommendation and stated it would comply by reconciling SET and RETT cash receipts credited to the School Aid Fund with amounts reported as paid by the counties, the Department has not complied.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE DEPARTMENT IMPROVE ITS ACCOUNTING FOR SET AND RETT.

AGENCY PRELIMINARY RESPONSE

The Department agrees to evaluate and improve the methods of reconciling the revenues to the State's accounting system. However, the Department does not support recording SET and RETT revenues by county in the State's accounting system.

FINDING

7. Collection and Oversight of Property Tax Revenue From Tax Increment Financing

The Bureau needs to improve its collection and oversight of property tax revenue from tax increment financing.

The Department identified \$42.4 million in excessive capture of property taxes that should not have been retained by local unit authorities, including \$15.8 million due to the State. The Bureau had not collected the State's portion of excessive capture that required repayment to the State and to school districts. In addition, the Department preliminarily identified an additional \$96.6 million in taxes that may have been retained by local unit authorities that may require repayment to the State and to school districts upon further review.

Tax increment financing authorities (TIFAs), downtown development authorities (DDAs), and local development financing authorities (LDFAs) use tax increment financing to finance public improvements in designated areas. Property taxes levied on incremental increases within the area are retained or "captured." Captured property taxes reduce revenue available to the State and local units of government. The State reimburses school districts for their portion of the tax that is captured.

The Bureau's Property Tax Division had conducted "audits" of captured property taxes to ensure that the appropriate amount of incremental taxes was captured by authorities from State and school district revenue. Also, the Bureau monitored State reimbursements established by Section 125.1663b of the *Michigan Compiled Laws* that are paid to qualified authorities for certain tax increment revenues lost as the result of a reduction in school tax available for capture. However, the Bureau must also collect the disallowed property tax capture it identifies to ensure that the Department receives all property tax revenue owed to the State.

RECOMMENDATION

We recommend that the Bureau improve its collection and oversight of property tax revenue from tax increment financing, including recovery of the State's portion of property taxes identified as having been retained by local unit authorities.

AGENCY PRELIMINARY RESPONSE

The Bureau would note that, beginning in March 2003, the Bureau has resumed review of tax increment financing reports for the purpose of determining which of these amounts can be collected and which must be restated. The Bureau agrees to improve its oversight of tax increment financing and, where appropriate, to collect the unremitted overcapture or to recommend to the State Tax Commission that it institute proceedings to enforce the provisions of the various tax increment financing statutes.

FINDING

8. Collection and Administration of the Trailer Coach Park Tax

The Department was not effective in its collection and administration of the trailer coach park tax from municipalities.

Department records indicated that \$17.5 million in trailer coach park tax was collected from local units of government in fiscal years 1997-98 through 2001-02. However, the Michigan Manufactured Housing Association reported that there were over 160,000 trailer coach sites located in Michigan trailer coach parks and the Michigan Campground Directory reported an additional 5,252 permanent year-round trailer coach sites located in Michigan campgrounds. Based on full occupancy, an additional \$3.5 million in School Aid Fund revenue may have been available through the trailer coach park tax to fund State education for fiscal years 1997-98 through 2001-02.

The trailer coach park tax, if collected, represents a revenue source to the School Aid Fund. For municipalities or counties that are collecting but not remitting the monthly trailer coach park tax or are transferring collections to school districts instead of the State, these municipalities, counties, or school districts may be improperly retaining State school aid funds.

For municipalities that are not collecting the trailer coach park tax, both the State and the local units are forgoing a source of revenue from trailer coaches that would help to fund the costs of public services consumed by trailer coach park residents, such as public schools and police and fire protection.

Section 125.1042 of the *Michigan Compiled Laws* requires the treasurer of a municipality, in which a trailer coach park is located, to collect monthly tax payments of \$3.00 per trailer coach located in the municipality and:

- a. Disburse \$.50 per trailer coach to the county treasurer for credit to the county general fund.
- b. Retain \$.50 per trailer coach for credit to the municipal general fund.
- c. Disburse \$2.00 per trailer coach to the State Treasurer for credit to the School Aid Fund.

Although ad valorem property tax is assessed on the real property underlying trailer coach parks, Section 125.1041 of the *Michigan Compiled Laws* exempts from property tax trailer coaches located in trailer coach parks. The trailer coach park tax is in lieu of any property tax levy on every trailer coach located in a trailer coach park.

According to the Michigan Manufactured Housing Association and the Michigan Campground Directory, all 83 Michigan counties have municipalities with licensed trailer coach parks and/or campgrounds requiring payment of the tax contained within their jurisdiction.

Our review of the Department's administration of the trailer coach park tax disclosed several deficiencies in the receipt, collection, and administration of the tax:

- (a) The Department had not established sufficient oversight of municipalities required to remit the trailer coach park tax.

The Department did not identify which municipalities had trailer coach parks located within their jurisdiction and did not monitor whether trailer coach park tax payments had been remitted by these municipalities.

Our review disclosed that the Department had not received any trailer coach park tax from several counties throughout the State. The Department records showed that 10 of the State's 83 counties failed to remit any payment for the

trailer coach park tax in at least 2 of the 5 years reviewed (1998 through 2002).

In addition, our review of trailer coach park tax collections for 13 counties disclosed 6 counties that were unaware of the existence of the tax, 3 counties that had inappropriately sent the State's portion of the tax to the local school district instead of to the Department, 1 county that remitted the tax annually instead of monthly, and 1 county that had underpaid the State by \$16,451.

- (b) The Department did not accurately account for trailer coach park tax collections.

Our review disclosed that the Department had erroneously recorded trailer coach park tax payments from Oakland County as SET in the State's accounting records. We determined that the Department had understated trailer coach park tax collections from Oakland County by \$1.4 million over the 5-year period reviewed (1998 through 2002).

Also, our review identified several trailer coach park tax payments that the Department erroneously recorded as Michigan State Housing Development Authority payments in lieu of tax.

- (c) The Department had not developed procedures to audit the trailer coach park tax to determine whether municipalities had remitted the correct amount of tax.
- (d) The Department did not provide municipalities appropriate instruction on remittance of the trailer coach park tax.

Department Letters 21-94 and 2002-6 instructed municipalities to remit the State's portion of the trailer coach park tax to county treasurers rather than directly to the State as required by statute. The Department letters further instructed counties, in turn, to remit the State's portion of the tax received from municipalities to the State, along with ad valorem SET collections.

This practice hinders the Department's ability to determine whether municipalities have paid the tax and is contrary to Section 125.1042 of the *Michigan Compiled Laws*, which requires each municipality to remit trailer coach park tax directly to the State.

RECOMMENDATIONS

We recommend that the Department improve its collection and administration of the trailer coach park tax from municipalities.

We also recommend that the Department recoup underpayment of tax collected.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees to develop a program to monitor the collection and timely remittance of the trailer coach park tax collected by local treasurers, within the amounts appropriated by the Legislature for that purpose.

FINDING

9. Collection of Specific Taxes

The Department did not determine whether local units of government that were required to remit specific taxes had remitted their portion of the taxes in the correct amount or at all.

Collection and remittance of the entire amount of the various specific taxes by local units of government impact the School Aid Fund balance, as well as the General Fund balance, which may be required to supplement school aid funding shortfalls under the State's school aid distribution formula.

Various statutes require local units of government to collect and remit to the Department an assortment of specific taxes:

- a. Sections 211.621 - 211.626 of the *Michigan Compiled Laws* exempt low grade iron ore mining property from ad valorem property taxes and require that a payment in lieu of tax be remitted to the Department to the credit of the School Aid Fund.
- b. Section 125.1415a of the *Michigan Compiled Laws* exempts housing projects under the State Housing Development Authority Act from ad valorem property taxes and requires that a payment in lieu of tax be remitted to the Department to the credit of the School Aid Fund.

- c. Sections 324.51101 - 324.51120 of the *Michigan Compiled Laws* exempt land designated as a commercial forest under the Natural Resources and Environmental Protection Act from ad valorem property taxes and require that a payment in lieu of tax be remitted to the Department to the credit of the School Aid Fund.
- d. Sections 324.51301 - 324.51312 of the *Michigan Compiled Laws* require that the local school district operating portion of ad valorem property taxes and fees paid for land designated as a private forest reservation under the Natural Resources and Environmental Protection Act be remitted to the Department and credited to the School Aid Fund.

The Department received the following specific tax revenue in fiscal years 1997-98 through 2001-02:

Specific Tax Collections

	Fiscal Year					Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	
Iron ore tax*	\$1,521,185	\$ 1,471,530	\$ 1,477,916	\$ 1,477,176	\$ 1,561,794	\$ 7,509,601
State housing development tax*	5,892,141	7,040,167	6,155,607	8,367,269	8,007,495	35,462,678
Commercial forest tax*	2,386,560	2,620,173	2,704,878	2,439,351	2,473,201	12,624,162
Private forest tax*	0	0	0	0	0	0
Total	<u>\$9,799,886</u>	<u>\$11,131,870</u>	<u>\$10,338,401</u>	<u>\$12,283,796</u>	<u>\$12,042,490</u>	<u>\$55,596,441</u>

Because the Department did not determine whether local units of government remitted specific taxes, we could not readily determine whether the preceding amounts represented all of the specific tax revenue that should have been received by the State.

RECOMMENDATION

We recommend that the Department determine whether local units of government that are required to remit specific taxes have remitted their portion of the taxes.

* See glossary at end of report for definition.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees to develop a program to monitor the collection and timely remittance of specific taxes, within the amounts appropriated by the Legislature for that purpose.

FINDING

10. Collection of Interest on Untimely Remittance of State Taxes

The Department did not require local units of government to pay interest when delinquent in making payments to the State.

Our review of the payment history of selected local units of government disclosed that these local units may not have remitted as much as \$82.8 million in State tax revenue. In addition, local units had not timely remitted an additional \$2.0 million in payments, as described in items c. and e. This could result in as much as \$32.6 million in associated interest also not being remitted to the State.

The Department is required under Section 211.87 of the *Michigan Compiled Laws* to prepare a quarterly statement of account between the State and each county of all money owed and due to each. Counties and local collectors from each assessing district, as applicable, are required to pay to the State Treasurer "for the use of the State" one-half of 1% for each month, or fraction thereof, as interest on all money possessed and belonging to the State and not timely remitted to the State. The Department is required to include all sums due as interest in its statements to the counties.

Because Section 211.87 of the *Michigan Compiled Laws* falls under the General Property Tax Act, other taxes (such as the trailer coach park tax [Finding 8] or other specific taxes [Finding 9]) that are not part of the General Property Tax Act, or expressly incorporated therein, may not technically be subject to the interest requirements. Amendatory legislation may be needed to give the Department the authority to assess and collect interest on these taxes.

The Department did not prepare State tax statements or quarterly statements of account between the State and each county and did not require local units of government to pay interest on State revenues in their possession that were not

remitted on a timely basis. Our review of remittances by local units to the Department disclosed:

a. Industrial Facility Tax

As described in Finding 1, local units of government had failed to remit \$67.0 million in industrial facility tax for tax years dating back to 1986. As of December 31, 2002, the State had not received \$14.8 million in interest associated with these late payments dating back to 1992.

b. Industrial Facility and Commercial Facilities Taxes (City of Flint)

In addition to the City of Flint's portion of interest described in item a. for late payments dating back to 1994, the State also had not received \$13.7 million in interest associated with \$12.0 million of tax owed by the City for tax years 1986 through 1991 (Finding 2).

c. Industrial Facility Tax (Olive Township)

In 1994, Olive Township (in Ottawa County) erroneously remitted \$412,930 in industrial facility tax to the Zeeland Public School District instead of to the Department as required by law. The school district held the money for approximately nine years before the error was finally brought to the Department's attention in 2003. The Department ultimately collected the tax on March 7, 2003. However, the State had not received or pursued collection of \$298,246 in interest associated with the nine-year delay in payment.

d. Tax Increment Financing Excessive Tax Capture

As discussed in Finding 7, the Department identified \$42.4 million in excessive capture of property taxes by TIFAs, DDAs, and LDFAs. The State's portion of this excess tax capture was \$15.8 million, resulting in \$3.6 million in interest owed to the State but not remitted to the Department.

e. Delinquent Property Tax Sales Cancellations

We reviewed 944 delinquent property tax sales cancellation remittances for 10 counties. Our review disclosed that 873 (92%) of sales cancellation remittances, representing \$1.6 million in State revenues, were remitted to the State an average of 18 months late. The State had not received \$160,769 in interest associated with these late payments.

The Department has encountered significant challenges in collecting State revenues from local units of government, including, for example, \$22.9 million from the City of Flint dating back as far as 1986 and \$412,930 from Olive Township/Zeeland Public School District dating back to 1994. The Department has exacerbated these challenges because it has not used interest charges as a tool to promote timely remittance of State revenues.

By requiring local units of government to pay monthly interest on untimely remittances, the Department provides to local units a strong incentive to tender payment of State revenues in a timely manner. The Department's laxness in securing interest due to the State has created an opportunity for local units to earn interest. For example, it has been reported that the Zeeland Public School District received more than \$587,000 in interest during the nine years that it held industrial facility tax revenues in its account. The interest payment requirement also provides the State a manner in which to recoup the opportunity cost borne by late payment of State revenues from local units.

RECOMMENDATIONS

We recommend that the Department enforce the provisions of the General Property Tax Act by requiring local units of government to pay interest when delinquent in making payments to the State.

We also recommend that the Department seek amendatory legislation to allow it to charge interest on local units' remittance of other State revenue collections, such as the trailer coach park tax (Finding 8) or other specific taxes (Finding 9) that may not be subject to the interest requirements under the General Property Tax Act.

AGENCY PRELIMINARY RESPONSE

The Department agrees that oversight of collection of taxes at the local level was insufficient to detect failures by local treasurers to remit taxes collected. The Department has already determined that it lacks sufficient statutory and procedural remedies against local treasurers to enable the Department to seek full restitution from local treasurers who do not comply with the law. The Department disagrees with the statement that Section 87 of the General Property Tax Act, especially in light of Section 87b of the same Act, gives the State the power to seek restitution from local units of government of lost opportunity costs caused by negligent or intentional behavior of local collecting officials relating to either general ad valorem

property taxes or any other specific taxes collected locally on behalf of the State. The Department will submit recommended legislation to give it these tools.

FINDING

11. Annual Audits of County Government

The Department did not provide for an annual audit of each Michigan county as required by law.

State audits of each Michigan county are necessary to fulfill the requirements of Article IX, Section 21 of the State Constitution and Section 21.45 of the *Michigan Compiled Laws*. Although counties contract with private accounting firms for their own audits, the objectives and scope of those audits are determined by the county management being audited and do not constitute "the auditing of county accounts by competent state authority" as required by the State Constitution. The State must exercise sufficient dominion over the county audit process in order to comply with constitutional and statutory requirements and to ensure that sufficient oversight exists over public funds, including State public funds such as State transportation funding to counties, State funding of trial court operations, and State environmental grants. State audits of counties also provide the Department with the opportunity to determine whether counties have remitted to the State Treasury all State revenues collected by the counties on the State's behalf, as illustrated by Findings 1 through 10.

Article IX, Section 21 of the State Constitution provides, in pertinent part:

The legislature shall provide by law for the annual accounting for all public moneys, state and local . . . and the auditing of county accounts by competent state authority

The Legislature has also provided in Section 21.45 of the *Michigan Compiled Laws* as follows:

The state treasurer may examine, or cause to be examined, the books, accounts and financial affairs of each county office. The examination shall be made at least once in each year, or as often as the state treasurer considers it to be for the public good.

The Department's Local Audit and Finance Division has not provided for the annual audit of each Michigan county since 1965, when the constitutional responsibility was transferred to the Department by Section 16.180 of the *Michigan Compiled Laws* under the Executive Reorganization Act of 1965.

The number and frequency of county audits has declined over time. For example, for the period 1968 through 1971, the Division completed 157 (47%) of 332 required annual audits (83 counties times 4 years). For the period 1973 through 1975, the Division completed 126 (51%) of 249 required annual audits. For the period 1976 through 1978, the Division completed 81 (33%) of 249 required annual audits. Also, a majority of the audits conducted during those periods included only the most recently completed year since the prior county audit, not an annual audit of each year.

For 2001, the Division completed only 4 (5%) of the required 83 annual county audits. These chargeback audits* were completed at the request of the audited counties.

RECOMMENDATION

We recommend that the Department provide for an annual audit of each Michigan county as required by law.

AGENCY PRELIMINARY RESPONSE

The Department disagrees with the finding that it did not provide for an annual audit of each Michigan county as required by law because it does provide for that audit within the limits of the amount of money appropriated for that purpose as required by Section 21.45 of the *Michigan Compiled Laws*. Beginning in 1991, the Legislature has appropriated \$60,000 per year for this purpose. The Department has spent that amount for that purpose each year. A financial audit of just one county can cost as much as \$35,000.

* See glossary at end of report for definition.

ADMINISTRATION OF DELINQUENT PROPERTY TAXES AND THE SPECIAL ASSESSMENT DEFERMENT FUND

COMMENT

Audit Objective: To assess the Local Property Services Section's effectiveness and efficiency in administering the delinquent property tax reversion process and the Special Assessment Deferment Fund.

Conclusion: We concluded that the Local Property Services Section was not effective and efficient in administering the delinquent property tax reversion process and the Special Assessment Deferment Fund. Our audit disclosed 4 material conditions related to the Delinquent Property Tax Administration Fund, revenue and accounts receivable reconciliations, accounting for delinquent property tax revenue, and Special Assessment Deferment Fund accounting (Findings 12 through 14 and 16). Our audit also disclosed reportable conditions related to recovery and recording of tax lien sales cancellations*, Special Assessment Deferment Fund verification notices, Special Assessment Deferment Fund accounts receivable and interest receivable, and continuous quality initiatives (Findings 15 and 17 through 19).

FINDING

12. Delinquent Property Tax Administration Fund

The Local Property Services Section did not exercise proper management and administrative controls over the Delinquent Property Tax Administration Fund.

Our review of the Department's accounts disclosed that it had incurred a \$6.4 million deficit condition, which was the result of an overstated Delinquent Property Tax Administration Fund balance.

Section 211.59 of the *Michigan Compiled Laws* established a restricted revenue fund called the Delinquent Property Tax Administration Fund. The Department is required to deposit in the Fund delinquent tax administrative fees, which are used to cover expenditures incurred in administering the General Property Tax Act. Section 18.1485 of the *Michigan Compiled Laws* requires the Department to

* See glossary at end of report for definition.

establish and maintain effective internal accounting and administrative control procedures over funds such as the Delinquent Property Tax Administration Fund.

A study of the chronology and events leading to and causing the fund deficit disclosed:

a. Accounting Records Show a Growing Surplus

The Department's accounting records showed that for several years administrative fees had been far exceeding the expenditures incurred in administering the General Property Tax Act. For example, from fiscal year 1991-92 through 1993-94, the Department's accounting records showed administrative fees recorded in the Delinquent Property Tax Administration Fund exceeding administrative costs by an average of \$371,585 per year. By the end of fiscal year 1993-94, the Department's accounting records showed the Fund had grown to a balance of \$6.4 million.

b. Department Shifts Funding to Support Technology Investment Plan and Presidential Primary Grants

In response to the surplus shown in the Delinquent Property Tax Administration Fund on June 25, 1999, \$3 million in fiscal year 1998-99 General Fund appropriations was transferred from the Department's Local Government Programs to its Technology Investment Plan and to Presidential Primary Grants. The Local Government Programs' \$3 million General Fund appropriation was replaced with \$3 million from the Delinquent Property Tax Administration Fund. Similarly, in fiscal year 1999-2000, Local Government Programs experienced a decline of \$3.3 million in General Fund appropriations in favor of funding from the Delinquent Property Tax Administration Fund.

c. Delinquent Property Tax Administration Fund Deficit of \$6.4 Million Results

In fiscal year 1999-2000, the Department discovered that balances in the Delinquent Property Tax Administration Fund were not sufficient to support the appropriations being funded from that account. A negative cash balance and cumulative deficit of \$6.4 million resulted. The cause of this deficit was the improper accounting of Delinquent Property Tax Administration Fund transactions by the Department. It was these accounting transactions that the Department relied on when making the General Fund transfers from Local Government Programs.

d. Accounting Errors Overstate Fund Balance

When tax lien sales were canceled, the Section reimbursed tax lien buyers for the amount the buyers had paid prior to cancellation. The Department's accounting for Delinquent Property Tax Administration Fund payments included establishing accounts receivable for funds it disbursed to tax lien buyers for canceled tax lien sales and billing counties (that possessed the funds) for the amount paid by tax lien buyers prior to cancellation. However, when counties reimbursed the State, the Department did not reduce the accounts receivable; instead, it recorded the reimbursement as revenue, which resulted in double counting the revenue and artificially inflating the fund balance by \$6.4 million.

e. Deficit Leads to Discovery of Accounting Errors

When the Department began shifting its funding source for Local Government Programs expenditures from General Fund appropriations to funding under the overstated balances in the Delinquent Property Tax Administration Fund, the true fund balance was rapidly depleted. This led to a deficit condition and the inevitable discovery of the \$6.4 million in accounting errors.

f. Supplemental Appropriation Required

As a result of the accounting errors and resulting deficit, the Department sought and was granted a supplemental appropriation authorization. For fiscal year 1999-2000, Act 291, P.A. 2000, appropriated to the Department for write-offs and advances an amount equal to the total write-offs and advances for Local Government Programs. The Act provided that the appropriation was not to exceed current year authorizations that would otherwise lapse to the General Fund.

The Section must exercise effective administrative control procedures over the Delinquent Property Tax Administration Fund to ensure that delinquent tax administrative fee revenues are properly accounted for, managed, and spent.

RECOMMENDATION

We recommend that the Local Property Services Section improve its management and administrative controls over the Delinquent Property Tax Administration Fund.

AGENCY PRELIMINARY RESPONSE

The Department notes that it discovered the deficiencies on its own between this audit period and the prior audit report and has corrected them. The Department informed us that the Delinquent Property Tax Administration Fund is in balance. The entire process related to the Delinquent Property Tax Administration Fund has been replaced by Act 123, P.A. 1999, and has dwindling application until 2006, when it expires altogether.

FINDING

13. Revenue and Accounts Receivable Reconciliations

The Local Property Services Section did not reconcile its revenue and accounts receivable records.

Periodic reconciliation of revenue and accounts receivable records is necessary to help ensure that revenue is properly recorded and to help detect or prevent accounting errors. Also, periodic reconciliation may have prevented the deficit that the Department experienced (see Finding 12).

Section 18.1485 of the *Michigan Compiled Laws* requires the Department to establish and maintain effective internal accounting and administrative control procedures. Effective internal control* procedures include periodic reconciliation of revenue to ensure that all transactions are properly recorded.

The Section is responsible for the receipt and accounting of payments associated with tax lien sales cancellations, delinquent property tax redemptions, and various delinquent tax program fees that are paid to the Department.

Our review disclosed the following weaknesses in the Section's reconciliation process:

- a. The Section did not submit its supporting records to the Department's Finance and Accounting Division for review.

* See glossary at end of report for definition.

In response to the accounting errors and deficit described in Finding 12, the Finance and Accounting Division developed reconciliation procedures for the Section in February 2001 and began monitoring the Section's reconciliations. The Section was required to begin performing reconciliations and to submit copies of its reconciliations and supporting records to the Division for review.

We determined that the Section submitted to the Division only a summary of its accounting entries, which was not consistent with the Section's actual transactions. If the Section had submitted its actual supporting records of transactions to the Finance and Accounting Division, those records would have disclosed that the Section had not properly reconciled its tax lien sales cancellation transactions, as described in item b.

The Finance and Accounting Division cannot assist the Section with its reconciliations unless it is provided accurate information for review.

- b. The Section did not reconcile tax lien sales cancellation transactions with the State's accounting system.

Instead of comparing State accounting records to the actual transactions that occurred, the Section simply compared its accounting balances to the source documents used to create those balances. Thus, the Section merely reconciled the State's accounting system with itself.

Unless the Section compares State accounting records to the actual transactions that occurred, its reconciliations cannot verify that the transactions were accurately recorded in the State's accounting system.

- c. The Section did not reconcile delinquent property tax reconveyance* transactions with the State's accounting system.

Property that is delinquent for taxes may be reclaimed by the original property owner through the process of either redemption or reconveyance upon payment of delinquent taxes and associated fees, penalties, and interest. Our reconciliation of the Department's reconveyance transactions disclosed that the Department did not transfer the correct amount of the Department of

* See glossary at end of report for definition.

Natural Resources' (DNR's) reconveyance fee to DNR. The Department underpaid DNR by \$7,670 in fiscal year 1997-98; \$1,450 in fiscal year 1998-99; and \$7,378 in fiscal year 1999-2000. In addition, the Department overpaid DNR by \$12,200 in fiscal year 2000-01.

A test of the Department's reconveyance transactions for fiscal years 1998-99 through 2001-02 disclosed that 9 (10%) of 87 reconveyances were improperly recorded in the State's accounting system, including 3 in fiscal year 2000-01 that were not detected by the reconciliation process. For each of these 9 transactions, the Section improperly recorded reconveyance fees as Section revenue instead of fees payable to DNR. As a result, DNR was underpaid its reconveyance fee.

- d. The Section did not segregate by year its record of redemptions, which is necessary to reconcile redemption transactions.

The Section's record of redemption transactions consisted of over 83 separate handwritten tax lien sales books containing thousands of tax lien sales entries by county. These manual tax lien sales books provided only a listing of tax lien sales by year. The Section marked the entries as "redeemed" when a redemption occurred. These books were not useful for reconciling redemption transactions because manual counts of every book for every year of the redemption period would be required each time to ascertain the amount due from counties or payable to lien holders.

- e. The Section did not properly reconcile tax lien purchase transactions with the State's accounting system.

In addition to redemption and reconveyance by the property owner, a tax lien on delinquent property can also be purchased by the public upon payment of delinquent taxes and associated fees, penalties, and interest. We tested 60 tax lien purchase transactions and found 5 (8%) that were improperly recorded in the State's accounting system. For each of these 5 transactions, the Section improperly recorded purchase transactions as reconveyance fees payable to DNR instead of payable to counties for delinquent taxes. As a result, DNR was overpaid its reconveyance fee and counties were underpaid for delinquent taxes and associated fees, penalties, and interest.

- f. The Section did not reconcile Delinquent Property Tax Administration Fund revenue or DNR reconveyance fees with the State's accounting system. As a result, the Section did not prevent or detect unrecorded fund revenue and accounts payable to DNR.

Our review of the Section's activities for fiscal year 1999-2000 disclosed that the Section did not record Delinquent Property Tax Administration Fund revenue or accounts payable to DNR for the entire months of June and July. This omission caused the Delinquent Property Tax Administration Fund and DNR accounts payable balances to be understated by \$127,154 and \$19,240, respectively.

We reported this condition in five prior audit reports dating back to 1976. Although the Department agreed with our prior audit recommendations, it has not complied.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION RECONCILE ITS REVENUE AND ACCOUNTS RECEIVABLE RECORDS.

AGENCY PRELIMINARY RESPONSE

During the beginning of the audit period, the Department's Finance and Accounting Division, under guidance of the Department's Internal Audit Division, established the method to reconcile these records and has now concluded that the Bureau's processes meet those requirements. The Department does not agree to expend additional resources to make any additional changes to the accounting for the Delinquent Property Tax Administration Fund, which is being phased out.

FINDING

14. Accounting for Delinquent Property Tax Revenue

The Local Property Services Section needs to improve its accounting for the Delinquent Property Tax Program.

Our review of the Section's accounting practices disclosed:

- a. The Section did not sufficiently account for revenues administered under the Delinquent Property Tax Program.

The Section had not developed separate revenue classifications for the various delinquent tax revenues, fees, penalties, and interest proceeds that it receives. All delinquent tax revenues (\$3 million from 1999 through 2001) were recorded under one general title description, i.e., "Local Property Services." Similarly, in anticipation of changes enacted under the new property tax reversion process of Act 123, P.A. 1999, the Section created only one general title description, i.e., "Land Reutilization Fund," to record all revenues to be collected under the new tax reversion process.

- b. The Section erroneously accounted for delinquent property tax redemptions received from local units of government and paid to tax lien holders.

The Section erroneously used 2 State accounts, entitled "Funds Paid To Lienholders" and "Redemptions From Local Units," interchangeably to record funds receipted from local units of government and paid to tax lien holders for redemptions. As a result, for example, the Section had misclassified \$629,207 in redemption funds received from local units of government for fiscal year 2000-01. Similarly, for example, the Section had misclassified \$580,256 in redemption funds paid to tax lien holders for fiscal year 2000-01.

The General Property Tax Act (Sections 211.1 - 211.157 of the *Michigan Compiled Laws*) provides for payment of various taxes, fees, and interest associated with the sale, redemption, forfeiture*, foreclosure*, and reconveyance of tax delinquent real property. Section 1800.115 of the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the Governmental Accounting Standards Board, states that such governmental fund revenues should be classified by fund and source.

Separate revenue classifications are necessary to effectively account for, identify, specify, and categorize the diverse assortment of sales, fee, and interest revenues being received under both the new and previous tax reversion enactments. The accounting classifications are important to determine whether the fees imposed are adequate to meet the expenditures incurred; whether the proper amounts of sales proceeds, fees, and interest are collected; and whether sales proceeds are deposited in the appropriate restricted account, segregated by year of sale, and credited in order of priority to the appropriate fund or expenditure.

* See glossary at end of report for definition.

Also, it is necessary that redemption fund revenues receipted from local units of government and disbursed to lien holders be correctly classified to prevent State accounting financial record misstatement.

RECOMMENDATION

We recommend that the Local Property Services Section improve its accounting for the Delinquent Property Tax Program.

AGENCY PRELIMINARY RESPONSE

The Bureau informed us that it corrected the deficiencies the Department found in accordance with the guidelines set out by the Department's Internal Audit Division. The Bureau also informed us that the fund is in balance and will have insufficient activity to warrant further procedural changes. The Department is developing the necessary internal accounting processes relating to the new property tax reversion process now that its provisions have taken effect.

FINDING

15. Recovery and Recording of Tax Lien Sales Cancellations

The Local Property Services Section needs to improve its administration of tax lien sales cancellations.

Tax lien sales cancellations may occur for various reasons, including when taxes are paid prior to sale or when an error is made in the description of the property. Our review of the Department's process for recovering and recording tax lien sales cancellations disclosed:

- a. The Delinquent Property Tax Section did not initiate periodic, timely recovery of sales cancellation proceeds from county treasurers.

When the Section issued refunds to tax lien buyers for sales cancellations, it billed counties for the amount that the State paid. However, it had been six months since the Section had pursued the related collection from counties. Of 83 counties, 26 (31%) had not reimbursed the State Treasurer on a timely basis, resulting in \$545,471 in sales cancellation proceeds due to the State as of May 2002.

Periodic and timely pursuit of sales cancellation proceeds from counties is critical to effective cash management. The utilization of telephone calls and collection letters to help in the collection of delinquent accounts, along with other administrative tools, are common practices used to effectively collect past due accounts. Such collection techniques could help recover these scarce State funds due from counties.

- b. The Department did not record unclaimed tax lien sales cancellations in the State's accounting system.

The Section did not record an account payable for tax lien sales cancellation refunds remaining unclaimed and still due to lien holders by the State. As of May 2002, unrecorded unclaimed tax lien sales cancellation refunds totaled \$194,161.

Also, the Section did not record the corresponding accounts receivable for unclaimed tax lien sales cancellation refunds due from counties. These proceeds must be returned to the State to support the refunds the State pays to tax lien holders once claimed or for eventual escheat under the State's Uniform Unclaimed Property Act. As of May 2002, the unrecorded accounts receivable for unclaimed tax lien sales cancellations totaled \$194,161.

Section 211.73 of the *Michigan Compiled Laws* requires the Department to refund to tax lien purchasers the amount paid at the time of the sale, with interest at the rate of 6% per annum, upon the cancellation of a delinquent tax sale. Because the proceeds of tax lien sales are paid to counties, not the State, the Department must then recover from counties all taxes, interest, and charges it paid to tax lien holders.

RECOMMENDATION

We recommend that the Local Property Services Section improve its administration of tax lien sales cancellations by periodic, timely recovery of sales cancellation proceeds and proper recording of tax lien sales cancellations.

AGENCY PRELIMINARY RESPONSE

As a part of the Department's correction to the process errors discovered by the Department, the Bureau informed us that it has instituted a system of collections that has resulted in balancing the account.

FINDING

16. Special Assessment Deferment Fund Accounting

The Local Property Services Section did not maintain complete subsidiary records for the Special Assessment Deferment Fund. Also, the Local Property Services Section did not properly reconcile the Special Assessment Deferment Fund with the State's accounting system.

These actions are necessary to help ensure that loans are properly accounted for and accurately presented in the State's financial statements and that the Department possesses accurate information necessary to effectively administer the Special Assessment Deferment Fund.

The Section is responsible for administering the Special Assessment Deferment Fund, which is used to assist an owner of a homestead* who is 65 years or older who is totally and permanently disabled in the payment of special assessments* through long-term low interest loans. The Section pays special assessments to local units of government on behalf of qualifying property owners and files a lien on the properties when it pays the special assessments. The payment of the special assessment is considered a loan to the individual, with repayment required prior to transfer or sale of the property. The process is called a deferment.

Section 211.768a of the *Michigan Compiled Laws* requires the Section to charge homeowners interest at a rate of one-half of 1% per month on deferments. When a property is transferred, the loan becomes a "terminated deferment," subjecting the former owner to additional interest of 1% per month on the amount deferred, computed from the date of transfer. During the period October 1998 through July 2002, the Section issued 121 new loans totaling \$681,126 and oversaw a total of 557 loans totaling \$1,033,507.

* See glossary at end of report for definition.

The Section maintains an automated accounting system for the Special Assessment Deferment Fund to record loans issued, interest charged, and repayments. Our review of the Section's records and procedures for the Special Assessment Deferment Fund disclosed the following deficiencies:

- a. Subsidiary records in the Section's automated accounting system did not include complete information for each individual loan. We determined that 285 (51%) of the 557 loan files within the automated accounting system contained incomplete information. For example, in 260 (91%) of the 285 cases, only a name and address were recorded. Consequently, the Section could not determine an individual property owner's loan balance without referring to an individual's loan file and computing the balances manually.

For the Section's automated accounting system to be effective, it should include complete information to ensure that transactions are properly recorded and to assist with the reconciliation of the Section's records with the State's accounting records.

A similar condition was also noted in our prior two audit reports dating back to 1991. The Section indicated that it agreed with both prior audit recommendations and would comply, but it has not.

- b. Subsidiary records in the Section's automated accounting system did not include information to calculate the number of months each loan was outstanding, the amount of interest accrued, or the date a property was transferred. Our review of the automated accounting system disclosed that 387 (69%) of 557 loans did not have the correct monthly interest amount entered in the system. Annual interest was overstated by an estimated \$147,185 per year in the Section's automated accounting system.

The Section's automated accounting system cannot function as an effective record of Special Assessment Deferment Fund transactions unless it includes the information necessary to determine the pay-off amount for each outstanding loan, including the number of months that each loan has been outstanding, the correct amount of interest, and any additional interest accrued since the date of transfer.

- c. The Section's automated accounting system did not include information to account for and collect terminated deferments. Our review identified a terminated deferment that has been due since 1985 that was not identified by the Section until 2000 and remains outstanding. The terminated deferment was not identified earlier because the Section's system did not track the terminated status of loans. When the Section began efforts in 2001 to collect the 1985 terminated deferment, the penalties and interest applied toward the balance due had grown to more than three times the original loan amount.

For the Section's automated accounting system to be effective, it must include information necessary to timely account for terminated deferments due for collection.

- d. The Section did not reconcile its accounting records for the Special Assessment Deferment Fund with the State's accounting system. We reconciled the Section's accounting records for loan repayments, new loan disbursements, and the Fund's cash balance for fiscal years 1997-98 through 2001-02. Our reconciliation as of July 1, 2002 disclosed unreconciled differences of \$87,021 for loan repayments and \$18,375 for new loan disbursements and an understated fund cash balance of \$104,286.

Reconciliation of the Special Assessment Deferment Fund ensures that deferments are properly accounted for and that transactions are accurately recorded and presented in the State's financial statements.

Our prior audit found that the Section did not properly reconcile its accounting records with the State's accounting system. The Section indicated that it would comply, but it has not.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION MAINTAIN COMPLETE SUBSIDIARY RECORDS FOR THE SPECIAL ASSESSMENT DEFERMENT FUND.

WE ALSO AGAIN RECOMMEND THAT THE LOCAL PROPERTY SERVICES SECTION PROPERLY RECONCILE THE SPECIAL ASSESSMENT DEFERMENT FUND WITH THE STATE'S ACCOUNTING SYSTEM.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the finding and stated that it has initiated the recommended changes.

FINDING

17. Special Assessment Deferment Fund Verification Notices

The Local Property Services Section had not sent periodic verification of ownership notices to special assessment deferment homestead owners to identify transferred or sold properties and subsequently collect terminated deferments.

At the time of our audit, the Section was responsible for determining when 557 loans and interest valued at \$1.3 million became due and payable to the State. Annual verification notices represent an effective means of monitoring deferments, identifying terminated deferments, and collecting loan and interest amounts due from terminated deferments on a timely basis.

Under Section 211.762 of the *Michigan Compiled Laws*, when a homestead is transferred, a special assessment deferment loan becomes a "terminated deferment," due and payable along with additional interest of 1% per month computed from the date of transfer. Section 211.762(3) of the *Michigan Compiled Laws* specifically requires the Section to do the following:

. . . [n]otify each owner whose special assessments are authorized to be deferred under this act that if legal or equitable title to the homestead or any part of the homestead is conveyed or transferred or a contract to sell the homestead or part of the homestead is entered into, the deferment is terminated and the amount deferred is immediately due and payable, plus interest. . .

Prior to 2000, the Section sent correspondence to all owners each year verifying continued ownership of the homestead. The correspondence required owners to sign statements affirming that they continued to own the homestead. The Section discontinued its practice of issuing verification notices in 2000.

RECOMMENDATION

We recommend that the Local Property Services Section send periodic verification of ownership notices to special assessment deferment homestead owners to

identify transferred or sold properties and subsequently collect terminated deferments.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the finding and stated that it has initiated the recommended changes.

FINDING

18. Special Assessment Deferment Fund Accounts Receivable and Interest Receivable

The Local Property Services Section did not properly calculate accounts receivable and interest receivable balances for the Special Assessment Deferment Fund.

The Section is responsible for calculating and reporting the accounts receivable and interest receivable balances for the Special Assessment Deferment Fund annually at fiscal year-end. The Department of Management and Budget requires accounts receivable information in preparing the *State of Michigan Comprehensive Annual Financial Report*.

Our review of the Section's calculation of accounts receivable and interest receivable balances for the Special Assessment Deferment Fund disclosed:

- a. The Section erroneously included interest receivable in its calculation of the accounts receivable balance for the Fund. Although the Section correctly excluded the fiscal year 2000-01 interest receivable balance from its calculation of accounts receivable, the beginning balance used in calculating the accounts receivable included interest receivable from previous years. As a result, the September 30, 2001 accounts receivable balance for the Fund was overstated by \$210,293.
- b. The Section calculated the Fund's interest receivable balance without including annual accrued interest. Section 211.768a(1) of the *Michigan Compiled Laws* states that special assessment loans are to be paid back with interest at a rate of one-half of 1% per month. The Fund's September 30, 2001 interest receivable balance was understated by \$242,502. In addition, this understated amount did not include penalty interest of 1% per month provided for under Section 211.762 of the *Michigan Compiled Laws* because

penalty interest was not readily determinable from the Section's accounting records for the reasons described in Finding 16.

RECOMMENDATION

We recommend that the Local Property Services Section properly calculate accounts receivable and interest receivable balances for the Special Assessment Deferment Fund.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the finding and stated that it has initiated the recommended changes.

FINDING

19. Continuous Quality Initiatives

The Local Property Services Section had not developed continuous quality initiatives to evaluate the effectiveness and efficiency of the Section's administration of the Delinquent Property Tax Administration Fund and the Special Assessment Deferment Fund.

Continuous quality initiatives would help the Section address the conditions described in Findings 12 through 18 by identifying, organizing, and prioritizing the Section's functions and responsibilities in order to more effectively and efficiently administer its duties. This has taken on increased significance for the Section with the advent of the delinquent property tax reforms enacted under Act 123, P.A. 1999, for example, because the State is now the responsible foreclosing governmental unit for 51 of the State's 83 counties.

Executive Directive No. 2001-3 states that it is the policy of the administration to ensure excellence and continuous improvement in the quality of services that State government provides to Michigan citizens. The necessary components of excellence and a continuous improvement process include the adoption of a mission* statement, establishment of measurable goals* and objectives*, and the collection of pertinent data to assess the attainment of those goals and objectives.

* See glossary at end of report for definition.

Our review of the Local Property Services Section disclosed:

- a. The Section had not developed or adopted a mission statement.

Although the Section is organizationally included within the Property Tax Division, the uniqueness of the Section's operations indicate a need for a mission statement specific to the Section's unique functions and responsibilities.

- b. The Section had not established quantified performance standards* or goals and objectives.

To assess the Section's effectiveness and efficiency, performance standards and goals are needed to describe the desired level of outputs* and outcomes* based on management's expectations. Also, a management information system is required to accurately gather relevant performance data, to compare performance data with desired outcomes, to report the comparison results to management, and to propose changes for improving the effectiveness and efficiency of the Section's management of the Delinquent Property Tax Administration Fund and Special Assessment Deferment Fund.

Examples of performance standards that the Section may consider adopting include minimum reconciliation requirements for revenues administered by the Section or an expected time limit for recovering sales cancellation proceeds from county treasurers.

Examples of performance goals and objectives that the Section may consider adopting include establishing the capability to account for redemption transactions by year or improving the timeliness and number of terminated deferments that are due for collection.

- c. The Section did not prepare annual financial and performance reports.

Financial statements are an important and necessary tool used to communicate the performance of a fund or program to management, the Legislature, and the public. Information disclosed can describe the status of

* See glossary at end of report for definition.

the fund or program and could be used to determine if changes need to be made to the laws governing the fund or program.

Information that would be useful and should be reported may include:

- (1) The number of delinquent properties redeemed and penalty and interest revenue earned.
- (2) The number of new special assessment deferment loans disbursed annually.

During the period October 1998 through July 2002, 121 special assessment deferment loans totaling \$681,126 were issued by the Section. This information is important to determine the utilization level of the Special Assessment Deferment Fund in projecting future needs.

- (3) The amount of interest earned by the Special Assessment Deferment Fund.

Section 211.768a(1) of the *Michigan Compiled Laws* requires interest at a rate of one-half of 1% per month to be added to all deferments made after January 8, 1981. Section 211.762(2) of the *Michigan Compiled Laws* requires an additional 1% per month interest to be added to deferments once the homestead is conveyed or transferred and the deferment is not terminated. This interest revenue is to be used to fund future loans. Annual accrued and paid interest is important information to be used to determine the financial status of the Fund for future loans. During the period October 1998 through July 2002, the average annual interest accrual was \$60,510.

- (4) The amount of payments paid back to the Special Assessment Deferment Fund.

During the period October 1998 through July 2002, \$841,889 in loans were paid, earning \$300,217 in penalties and interest.

- (5) The balance of the Special Assessment Deferment Fund.

As of July 1, 2002, the cash balance of the Fund was \$653,105. Along with the information from items a., b., and c., one could establish whether the balance of the Fund would continue to support new loans in subsequent years.

RECOMMENDATION

We recommend that the Local Property Services Section develop continuous quality initiatives to evaluate the effectiveness and efficiency of the Section's administration of the Delinquent Property Tax Administration Fund and the Special Assessment Deferment Fund.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the finding and informed us that it has initiated the development and implementation of program statements, goals, and objectives for all sections within the Bureau.

REVIEW AND AUDITS OF LOCAL UNITS OF GOVERNMENT

COMMENT

Audit Objective: To assess the Local Audit and Finance Division's effectiveness and efficiency related to reviewing and conducting audits of local units of government.

Conclusion: We concluded that the Local Audit and Finance Division was not effective and efficient in reviewing and conducting audits of local units of government. Our audit disclosed 2 material conditions related to oversight of local units of government and performance audits of State transportation funds (Findings 20 and 21). Our audit also disclosed reportable conditions related to fraud inquiries and complaints, filing of required reports and notifications, updating of local unit accounting and auditing guidance, chargeback audit billing rates and cost recovery, and receipt of municipal finance filing fees (Findings 22 through 26).

FINDING

20. Oversight of Local Units of Government

The Local Audit and Finance Division did not effectively oversee the accounting and auditing of public funds for local units of government.

Sections 141.421 - 141.440a of the *Michigan Compiled Laws* require the State Treasurer to prescribe minimum accounting and auditing procedures and standards for local units of government and provide for local unit audit and financial report filings.

Our review of the Division's oversight of accounting and auditing of local units of government disclosed the following weaknesses:

- a. The Division did not determine whether each local unit of government received an audit as required by law.

A "local unit of government" is defined for purposes of Section 141.425 of the *Michigan Compiled Laws* as a city, a village, or a township or an authority or a commission established by a county, city, village, or township resolution, motion, ordinance, or charter. The Division had not identified all authorities and commissions which had been established in the State that required an audit. For example, the Division's records showed it had identified 219 TIFAs, DDAs, and LDFAs that required an audit. However, the State Tax Commission's records showed that 513 authorities of this type existed in the State as of October 11, 2002.

Identification of all local units of government subject to audit is necessary to the process of determining whether the local units have complied with the audit and reporting requirements established by law.

- b. The Division did not ensure timely submission of local unit audit reports.

Section 141.427 of the *Michigan Compiled Laws* requires local units of government to submit copies of their audit reports to the State Treasurer within six months of the local units' fiscal year-end. As of July 2002, the Division had not obtained 1,459 (69%) of the 2,125 fiscal year 2000-01 audit reports from the authorities and commissions it had identified as subject to audit throughout

the State. Of the 666 audit reports that were received, 41 (6%) were received more than 7 months beyond the local units' fiscal year-end, including 1 audit report received 14 months beyond the local unit's fiscal year-end.

Timely submission of audit reports would help the Division to identify the financial stability, improper or illegal activities, or departures from applicable standards of the local units of government.

- c. The Division excluded certain local unit audit reports from its review.

Because of the quantity of audit reports received, the Division did not review each local unit audit report filed under Section 141.427 of the *Michigan Compiled Laws*. The Division indicated that it examined all audits of primary local governments, but it did not consider for review audits of the local governments' component units, such as authorities, commissions, and libraries, because the Division expected these component units to be included in the audit of the primary government. However, the Division did not ascertain whether these component units were, in fact, included as a part of the primary local governments' audits that were examined or were separately audited and reported entities. Component unit audit reports comprised a majority of the audit reports received according to the Division's audit activity log.

The Division should verify that component units were included within the scope of the primary local governments' audits examined and separately examine any component unit audit reports that were not covered in the primary governments' audits to ensure sufficient oversight and audit coverage of all local units of government.

- d. The Division did not ensure that local units of government obtained and submitted a report of comments and recommendations.

We noted that the Division did not obtain a report of comments and recommendations for 7 (30%) of the 23 fiscal year 2000-01 local unit audit reports we examined. A report of comments and recommendations should have been submitted because the audit reports indicated noncompliance with State statutes, deficits, or overspending of budgets. In addition, of the remaining 16 audit reports, 4 (25%) did not disclose deficits, overspending of

budgets, and a lack of a general fixed assets account group in the reports of comments and recommendations.

The Department's Bulletin for Audits of Local Units of Government requires that a report of comments and recommendations be prepared with each audit report to highlight certain improper or illegal acts, noncompliance with State statutes, and departures from generally accepted accounting principles. The reports of comments and recommendations help the Division identify significant deficiencies occurring in local units of government, which are described within the audit reports.

- e. The Division did not ascertain whether local units of government corrected significant internal control and accounting deficiencies disclosed in audit reports.

The Department is responsible for prescribing minimum accounting and auditing procedures for local units of government and for receiving related audit report filings. The Division periodically reviews these local unit audit reports to determine whether corrective action was taken on significant deficiencies reported. For reports with significant deficiencies, the Division sends a letter to the local units requesting a response as to the actions taken to correct the deficiencies. We determined that the Division had not determined whether local units had remedied significant internal control and/or accounting deficiencies reported in 11 (48%) of 23 local unit audit reports we examined.

Reviewing corrective action taken by local units of government helps the Division determine if deficiencies identified in the reports filed with the Department have been remedied.

- f. The Division did not ensure the timely receipt of required annual financial reports from local units of government.

In addition to the local unit audit reports described in item b., Section 141.424 of the *Michigan Compiled Laws* requires local units to file annual financial reports with the State Treasurer within six months of the local units' fiscal year-end. Section 141.921 of the *Michigan Compiled Laws* allows the Department to withhold revenue sharing payments from local units that fail to file required

financial reports within six months of fiscal year-end. Of the 1,860 annual financial reports that the Division expected to receive from local units for fiscal year 2000-01, 286 (15%) had not been received as of August 26, 2002. In addition, 152 (8%) of the 1,860 expected reports were 2 to 10 months delinquent, including 5 that had remained delinquent for 9 months or more. Despite the length of delinquency, the Department had not taken action to initiate revenue sharing withholding in these instances.

Timely receipt of annual financial reports is required by law and helps the Department to oversee the local units of government. Revenue sharing withholding provides the Department with an effective means to compel timely submission of financial reports.

RECOMMENDATION

We recommend that the Local Audit and Finance Division improve its oversight of the accounting and auditing of public funds for local units of government.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees that it has not taken steps to identify all active authorities and commissions. The Bureau will undertake a study to determine whether State resources, such as the Secretary of State and Library of Michigan, may assist in the identification of authorities and commissions. The Bureau stated that, although it does follow up on those authorities and commissions that are specifically identified and included as component units within an audit, it intends to strengthen its procedures associated with the verification and identification of any component unit that may not have been included within an audit.

The Bureau informed us that it does pursue the local unit or auditor when comments and recommendations are not submitted if pursuing that information is efficient in light of the nature of the direct disclosure in the audited reports.

The Bureau also informed us that it is studying methods of strengthening its oversight of internal control and accounting deficiencies, including considering legislatively authorized tools other than or in addition to the procedures for takeover under the Fiscal Responsibility Act.

FINDING

21. Performance Audits of State Transportation Funds

The Local Audit and Finance Division had not completed sufficient performance audits to establish accountability over annual payments to local units of government totaling approximately \$1.2 billion in State transportation funds.

Auditing payments of State transportation funds helps reduce the risk of undetected misuse and/or improper retention of transportation funds by local units of government.

Section 247.662 of the *Michigan Compiled Laws* requires the Department to conduct performance audits and investigations of the disposition of all State funds received by county road commissions or other applicable county road authorities in order to determine compliance with the terms and conditions of the Michigan Transportation Fund Act. Section 247.663 of the *Michigan Compiled Laws* similarly provides that such performance audits be conducted of cities and villages receiving State transportation funds.

The Legislature authorized the Department to hire three full-time auditors and provided appropriations for the Department to complete performance audits of State transportation funds. However, the Division assigned only one full-time auditor to conduct performance audits and dedicated only 1,540 hours to performance audits during fiscal year 2000-01. During fiscal years 1997-98 through 2001-02, the Division had completed only 9 (3 counties and 6 cities and villages) performance audits of State transportation funds. At this rate, it would take the Division over 10 years to complete only 6 performance audits of the State's 83 county road authorities and 12 audits of the State's 533 cities and villages receiving State transportation funds.

RECOMMENDATION

We recommend that the Local Audit and Finance Division complete more performance audits to establish accountability over payments of State transportation funds to local units of government.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with the facts presented in this finding but disagrees with the implication that the Bureau could have complied in the time frame suggested. The

first steps were to develop a performance audit process, a task not usually performed by the Department. In light of recent budget reductions and hiring freezes, the Bureau is now determining which other programs to discontinue to permit it to conduct performance audits.

FINDING

22. Fraud Inquiries and Complaints

The Local Audit and Finance Division did not effectively administer fraud inquiries and complaints.

The Division's Special Audit Section is responsible for conducting fraud inquiries, embezzlement examinations, and investigations of improprieties and illegal use of public money occurring in local units of government. A complainant, such as the Attorney General, a local unit official, or a citizen, may file a complaint with the Section regarding a county or other local unit of government.

Our review of the Division's administration of fraud inquiries and complaints disclosed:

- a. The Section did not prepare a correspondence or intake log of fraud inquiries/complaints received, date-stamp letters of complaint, or assign case numbers for complaints. Such measures would help ensure that each complaint received is accounted for and duly considered for investigation.
- b. The Section did not maintain a record of its review and evaluation of complaints received. When a fraud inquiry/complaint was received, it was forwarded directly to the Section manager to consider whether further action was warranted. If no action was taken, the inquiry/complaint was simply set aside. Maintaining review and evaluation records would document the deliberations that led to the decision regarding what action, if any, was taken and the basis on which that decision was founded.
- c. The Section did not prepare the special investigative checklist. Department of Treasury Documentation Manual procedure PL-70010 requires the Section to prepare a special investigative checklist to document the Department's receipt, handling, and disposition of each written complaint received. Maintaining a

special investigative checklist would document the status and disposition of written inquiries/complaints, help the Section manage and prioritize resources in responding to inquiries/complaints, and provide accountability in measuring and evaluating the Section's performance.

- d. The Section did not send complainants a letter explaining the reasons that action was not taken on their complaint or a copy of the resultant audit report. Department of Treasury Documentation Manual procedure PL-70010 requires the Section to send each complainant either a letter explaining the reasons that action was not taken on the complaint or a copy of the resultant audit report, as applicable. Providing a response to each inquiry/complaint would provide the inquirer/complainant notice that his or her inquiry/complaint has been received and considered and what action, if any, was taken as a result.

Effective administration of fraud inquiries and complaints would help ensure that all fraud inquiries and complaints are evaluated and investigated as appropriate.

RECOMMENDATION

We recommend that the Local Audit and Finance Division improve its administration of fraud inquiries and complaints.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and stated that it has begun to implement a procedure to correct it.

FINDING

23. Filing of Required Reports and Notifications

The Department had not filed reports and notifications with the Legislature and other State offices and local units of government as required by law.

As supervisor of the accounts of all county offices and the State agency responsible for auditing those accounts, the Department is required to file an assortment of reports and notifications to the Legislature and other State offices

and local units of government. Our review disclosed that the Department had not filed the following required reports and notifications:

- a. The Local Audit and Finance Division had not published an annual summary of county financial information since approximately 1980.

Section 21.44 of the *Michigan Compiled Laws* requires each county office to prepare an annual financial report in accordance with forms prescribed by the State Treasurer and to submit the report to the State Treasurer within six months after the end of the fiscal year. The Department is required to summarize and publish information submitted by the counties in an annual volume of comparative statistics. A copy of the volume is to be furnished to each member of the Legislature and to each county office and be made available to the public.

- b. Since 1980, when the requirement was added by statute, the Local Audit and Finance Division had not notified the Legislature of local units of government that have failed to file required reports and audits.

As described in Finding 20, the Local Audit and Finance Division is responsible for monitoring the receipt of annual financial reports and audits from local units of government.

Section 141.921(3) of the *Michigan Compiled Laws* requires the Department to notify each house of the Legislature of any local unit that fails to provide an annual financial report or audit as required by Section 141.921(1).

- c. Since 1988, the Department had not filed the required annual reports detailing the audits performed for the fiscal year and the charges for those audits.

The Department's annual appropriations acts require it to charge for audits as permitted by State or federal law, to submit a report detailing the audits performed for the previous fiscal year and the charges for those audits, and to send the report to the State budget director and to the Senate and House Fiscal Agencies not later than November 30 of each year.

The filing of required reports and notifications with the Legislature, State offices, and local units of government keeps concerned parties apprised of the financial activities and fiscal health of local units. Especially critical are notifications that inform the Legislature of local units that may be experiencing financial difficulties, such as evidenced by a local unit's refusal or inability to file required reports on a timely basis.

RECOMMENDATION

We recommend that the Department file reports and notifications with the Legislature and other State offices and local units of government as required by law.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and stated that it has begun to transmit reports on delinquent audits, delinquent annual reports, and audit charges.

FINDING

24. Updating of Local Unit Accounting and Auditing Guidance

The Local Audit and Finance Division did not update accounting and auditing guidance for local units of government.

Article IX, Section 21 of the State Constitution requires that the Legislature provide by law for the maintenance of uniform accounting systems by local units of government. The Legislature has so provided under the Uniform Budgeting and Accounting Act (Act 2, P.A. 1968, as amended, being Sections 141.421 - 141.440a of the *Michigan Compiled Laws*), which requires the State Treasurer to formulate and establish a uniform chart of accounts and various other reporting requirements for local units of government. The State Treasurer has designated the Local Audit and Finance Division to carry out this responsibility.

The Division has created 29 procedures, bulletins, manuals, letters, and audit guides to provide guidance to local units of government and their auditors for a uniform accounting system and audits. These publications are available for purchase from the Division and 11 are also available on the Department of Treasury Web site at no charge.

The Division had not updated many of these publications for extended periods of time. Of the 29 publications available for purchase as of October 2002, 9 had not been updated since the 1980s and 2 had not been updated since 1977 and 1978. Our review of 2 publications disclosed:

- a. The Division's Legal Compliance Manual for County Boards of Commissioners was last updated in July 1988. The Manual contains reference to 23 sections of law that have been subsequently repealed and 120 public acts with content changed by amendment since July 1988.
- b. The Division's audit bulletin of "Attorney General Opinions for County Road Transportation Authorities and Agencies" was last updated in April 1981. We identified 12 formal Attorney General opinions regarding county road transportation authorities issued since April 1981 that were not included in the audit bulletin.

Regularly updating accounting and auditing guidance for local units of government as applicable standards and statutory requirements change would help to ensure that local units have accurate information necessary to follow the proper procedures for controlling, accumulating, and reporting financial information.

RECOMMENDATION

We recommend that the Local Audit and Finance Division update its accounting and auditing guidance for local units of government.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and stated that it has developed a revision schedule, which encompasses a five-year period. The Bureau also stated that all but one relevant manual have been updated since 2001 and that it has removed the manuals that are not its responsibility to update or are no longer relevant.

FINDING

25. Chargeback Audit Billing Rates and Cost Recovery

The Local Audit and Finance Division needs to improve its billing for chargeback audits.

Regularly updating its hourly billing rates for chargeback audits and using the actual amount of all audit costs would help the Division ensure that its billing rate charges result in an appropriate fee for chargeback audit services and provide sufficient revenues to cover the costs of the audit services.

The Division provides audit services to local units of government that request the Division to perform their financial audits, referred to as "chargeback audits." Funding to support these audits is derived from the amounts billed to the local units that request the audits. A billing rate is to be established by the Division based on the contracted hours for each audit, at a billing rate sufficient to recover the cost of performing the audits.

Our review of chargeback audit billing rates and cost recovery disclosed:

- a. The Division did not regularly update the hourly rates used in billing for chargeback audits. The Division last revised its hourly billing rate for chargeback audits in March 1999, effective for the fiscal years ended December 31, 1998 and later. The Division continued to bill at the 1999 rate for its audits performed through 2002.
- b. The Division did not include all its audit costs when formulating its audit billing rates. The Division did not include costs of all staff involved in the audit process, as well as certain other audit related costs, such as travel and computer costs.
- c. The Division did not use its actual costs when computing its audit billing rates. The Division computed its hourly billing rates for chargeback audits using estimated, rather than actual, costs. In addition, the Division did not periodically determine the reasonableness of its estimates.

RECOMMENDATION

We recommend that the Local Audit and Finance Division improve its billing for chargeback audits.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and informed us that it has revised its billing rate based on actual cost and developed a system to review the billing rate annually.

FINDING

26. Receipt of Municipal Finance Filing Fees

The Department needs to improve its accounting and cash handling procedures for the receipt and processing of cash for municipal finance filing fees.

Sections 141.2303 and 141.2319 of the *Michigan Compiled Laws* require that all municipalities pay the Department a filing fee ranging from \$100 to \$2,000 for each municipal security issued by a municipality, plus a \$100 late fee if applicable. Prior to May 2002, the filing fee ranged from \$100 to \$400 and applied to only select municipalities.

Department of Treasury Documentation Manual procedure ET-03009 requires Department employees to direct persons wishing to make a payment to the cashier's office where a drop box and payment envelopes are available.

However, the Municipal Finance Section accepted filing fees directly from walk-in applicants. For fiscal year 2000-01, Section staff received \$218,800 (84%) of \$261,300 in total filing fees. The remaining \$42,500 (16%) of filing fees was received by the Receipts Processing Division through the mail.

We noted the following weaknesses in the receipt and processing of municipal finance filing fee payments from debt issuance applicants that need to be corrected if the Section continues to accept filing fees directly from walk-in applicants:

- a. The Section did not maintain a record of cash received and did not issue a prenumbered cash receipt to document the receipt of cash from each filing fee paid. Documenting cash received is necessary to allow the Section to verify that all cash received was deposited.
- b. The Section did not separate the duties of staff receipting cash from those responsible for processing applications. The person responsible for

processing applications should not also be the person responsible for receipting cash payment of application fees because each provides a necessary check on the accuracy of the other's activities.

- c. The Section did not deposit filing fees in a timely manner. Timely deposit of cash receipts ensures the security of State revenues and interest revenue to the State.
- d. The Section did not reconcile its cash receipts with deposit records or the State's accounting system. Periodic reconciliation of revenue is needed to ensure that all money received was deposited and accounted for.

Department of Management and Budget Administrative Guide procedure 1270.02 requires that State departments establish adequate controls over cash receipts, including maintaining a record of cash received, using prenumbered cash receipts, avoiding the complete handling of cash by only one employee, depositing and recording cash receipts timely, and reconciling cash receipts periodically.

RECOMMENDATION

We recommend that the Department improve its accounting and cash handling procedures for the receipt and processing of cash for municipal finance filing fees.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and stated that it has ceased accepting checks from walk-in applicants. The Bureau informed us that all checks are now processed through the Department's Receipts Processing Division.

ADMINISTRATION OF PROPERTY TAX

COMMENT

Audit Objective: To assess the Property Tax Division's effectiveness and efficiency in administering the functions of the property tax program and the training and certification of assessors.

Conclusion: We concluded that the Property Tax Division was generally effective and efficient in administering the functions of the Property Tax Division and the

training and certification of assessors. However, our audit disclosed reportable conditions related to oversight of county equalization, personal property assessments, and State Assessors Board revenue (Findings 27 through 29).

FINDING

27. Oversight of County Equalization

The Property Tax Division did not effectively oversee county equalizations to ensure that the State equalized value for each class of property was accurately assessed for each county.

We identified the following areas in which the Property Tax Division needs to improve its oversight of county equalization:

- a. The Property Tax Division did not evaluate and report county equalization in a uniform and consistent manner and did not address deficiencies noted in Division field staff's evaluation of county equalization.

The Division's evaluation of county equalization includes a report of whether it agreed with the county equalization departments' property valuations. Our review of 15 Division reports disclosed 1 instance in which the Division expressly disagreed with the county equalization department's property valuations and 2 instances in which the Division did not indicate whether it agreed with the county equalization departments' property valuations. Division records did not indicate what, if any, action was taken to address these matters prior to accepting the county valuations.

In addition, the Division's evaluation of whether county sales studies complied with the State Tax Commission Assessor's Manual, resulted in realistic study of true cash value, or represented an appropriate use of the study contained only 1 affirmative response in the 15 evaluations we examined. Of the remaining 14 evaluations, 3 Division reports concluded "NA," 1 report indicated that studies were not performed, and the other 10 reports contained no response at all.

The Division should evaluate and report county equalization on a uniform and consistent basis and address the deficiencies noted by Division field staff in

their reports to ensure that a proper determination of State equalized value for each class of property for each county is achieved.

- b. The Property Tax Division did not receive equalization studies from some counties in a timely manner.

County equalization studies are due by December 31 of each year in order to afford the Property Tax Division sufficient time to evaluate whether there are errors or omissions in the counties' methodology and to take further action if necessary prior to accepting the assessment values. We determined that for tax year 2002, only 49 (59%) of 83 county equalization studies were received by the December 31 deadline. Similarly, for tax year 2001, only 51 (61%) of 83 county equalization studies were received by December 31 and, for tax year 2000, only 49 (59%) of 83 county equalization studies were received by December 31.

The results of county equalization studies must be provided to the Division in a timely manner so that Division staff have sufficient time to review, evaluate, and determine whether the county equalization studies are satisfactory or, if further equalization processes are necessary, to ensure an accurate determination of the true cash value for a county.

- c. The Property Tax Division did not maintain documentation of its evaluation of the county equalization process.

The Division compiled fill-in-the-blank evaluations of individual counties that concluded, for example, whether the Division's determination of true cash value agreed with the counties' true cash value. The Division did not document its own studies, reviews, assessments, or other sources upon which it based its conclusions. In addition, portions of the Division's evaluations were often incomplete, containing ambiguous conclusions.

The Division should document its evaluation of the county equalization process to provide management with the ability to oversee the work of Division field staff for uniformity and consistency, as well as compliance with appropriate assessing policies, procedures, and standards.

Section 209.6 of the *Michigan Compiled Laws* provides that, in order to ensure fair, equal, and uniform property valuations, it is the duty of the State Tax Commission to establish the State equalized value for each class of property for each county in the State as determined by the Commission's most recent examination of property values. *Michigan Administrative Code* R 209.41 requires county equalization departments to provide to the Commission by December 31 an equalization study of the assessed valuations and true cash value of each class of real and personal property in order to determine total valuations for county and State equalization purposes. *Michigan Administrative Code* R 209.42 requires the Commission's staff in the Property Tax Division to oversee county equalization departments in conducting the county equalization studies by reviewing sales information and appraisal methods and by observing and reporting compliance or noncompliance with the State Tax Commission Assessor's Manual. Also, *Michigan Administrative Code* R 209.42 provides that the Property Tax Division shall inform the Commission when the methods employed by a county equalization department will not produce an accurate determination of true cash value for a county. If a county fails to prepare a proper equalization study, the Commission is authorized under Section 209.104a of the *Michigan Compiled Laws* to prepare or cause to be prepared a proper equalization study at the county's expense.

RECOMMENDATION

We recommend that the Property Tax Division improve its oversight of county equalizations to ensure that the State equalized value for each class of property is accurately assessed for each county.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and is developing a process to resolve the matter. The Bureau also agrees with the finding to the extent that it involves the content of the checklist and stated that it has initiated a new procedure to provide more detailed documentation of field staff conclusions and retention and monitoring of those field evaluations in Lansing.

FINDING

28. Personal Property Assessments

The Property Tax Division needs to improve its supervision of and assistance to local assessors and county equalization departments in establishing and maintaining effective programs to assess personal property.

Making improvements in the supervision and assistance of personal property programs to local units of government could provide better enforcement of personal property taxes, resulting in additional State tax revenue, while ensuring more equitable and uniform application of the tax throughout the State.

Sections 209.104 and 211.150 of the *Michigan Compiled Laws* provide that it is the duty of the State Tax Commission to:

- a. Exercise general supervision over the administration of the tax laws of the State, including general supervision over the assessing officers of the State.
- b. Render assistance and give advice and counsel to the assessing officers of the State as necessary and essential to the proper administration of the laws governing assessments and the levying of taxes in this State.

Also, Section 211.150 of the *Michigan Compiled Laws* provides that it is the duty of the State Tax Commission to:

- a) Enforce the provisions of the General Property Tax Act so that all properties of this State liable to assessment are uniformly assessed for inclusion in the tax base.
- b) Require, on forms prescribed by the Commission, the information necessary to enable the Commission to ascertain the assessed value and equalized values of all property under the General Property Tax Act, including a separate listing of the valuations of all personal property classifications within the assessing unit.

The State Tax Commission examines whether local assessors have established a personal property program to discover and assess taxable personal property. The State Tax Commission requires assessors to send a prescribed personal property

form to any person or entity that may possess assessable personal property. Also, the State Tax Commission Assessor's Manual provides that local assessors' personal property programs shall include obtaining annual statements from owners of taxable property and canvassing to discover unreported property.

The Property Tax Division provides staff support to the State Tax Commission and is responsible for determining whether assessments are uniform. However, the Division has not conducted any field studies of personal property in approximately 28 years to ensure that personal property is uniformly assessed. Division field staff have annually performed a limited survey and review of the procedures performed in the equalization process for personal property by county equalization departments. This survey has consistently shown that widespread deficiencies exist in the personal property programs of many counties. For example, the Division's 2001 survey disclosed:

- (a) Nineteen (23%) county equalization departments had not complied with the requirements of the State Tax Commission Assessor's Manual for review and verification of personal property assessments. Personal property tax assessments for these 19 counties totaled approximately \$76 million in 2000. Eleven (58%) of these 19 counties were also in noncompliance during our prior audit period (January 1, 1992 through September 30, 1995).
- (b) Eighteen (22%) county equalization departments and the local assessors for those counties had not established an adequate personal property program to discover and assess all taxable property. In these cases, adequate programs had not been established to audit personal property statements and to canvass for unreported property.
- (c) Ten (12%) county equalization departments had not performed a personal property study or had not performed a study that resulted in a realistic estimate of the true cash value of personal property subject to taxation.

The Department informed us that it lacks enforcement sanctions to compel local unit of government compliance with applicable law.

Personal property assessments represent a significant portion of total State property tax revenues. State equalized values for personal property in fiscal years 1998-99 through 2000-01 ranged from \$28 to \$30 billion, represented 9% to 11%

of total State equalized valuations of property subject to taxation, and resulted in approximately \$1.2 billion in annual property tax levies. These levies support the School Aid Fund through the State education tax (SET).

Also, personal property assessments impact the education funding of local and intermediate school districts and essential local government public services, such as fire and police protection, and public transportation, libraries, and parks. Further, State equalized valuations are important factors used in calculating the correct amount of State school aid distributions to schools and State revenue sharing distributions to local units of government.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE PROPERTY TAX DIVISION IMPROVE ITS SUPERVISION OF AND ASSISTANCE TO LOCAL ASSESSORS AND COUNTY EQUALIZATION DEPARTMENTS IN ESTABLISHING AND MAINTAINING EFFECTIVE PROGRAMS TO ASSESS PERSONAL PROPERTY.

AGENCY PRELIMINARY RESPONSE

The Property Tax Division disagrees that it has not improved its supervision of and assistance to local assessors and county equalization departments in establishing and maintaining effective programs to assess personal property. The Bureau informed us that, during the audit period, the Property Tax Division did all of the following:

- Assisted the State Tax Commission in adopting new original-cost multipliers for the valuation of all personal property in Michigan.
- Wrote and distributed three bulletins with respect to the use of these new multipliers.
- Conducted Statewide training sessions on the use of the new multipliers.
- Wrote and distributed Bulletin 1 of 1999 regarding the proper reporting of personal property assets.
- Revised the personal property statement.

- Transmitted annual memoranda concerning illegal reporting practices by certain taxpayers.
- Revised the multiplier table used for the valuation of gas distribution pipelines.
- Provided, to local assessors, copies of court decisions concerning the valuation of personal property.

The Bureau also informed us that it recently implemented Act 161, P.A. 2003, by approving approximately \$4 million in grants to cities, townships, and counties to pay a portion of costs associated with conducting personal property audits under Section 22 of the General Property Tax Act.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

In fiscal year 2003-04, the Legislature appropriated \$7 million for State "grants to local government for activity under MCL 211.22a." This, and the Department's granting of \$4 million of these funds, does represent action to improve enforcement of personal property taxes. However, the balance of the Department's response describes routine duties and activities of the Property Tax Division, not improvements in local unit supervision and assistance by the Division. For example, it is unlikely that transmitting annual memoranda and providing local assessors copies of publicly disseminated court decisions will result in establishment of adequate personal property programs in 18 counties or the performance of personal property studies for 10 counties. Improvements are recommended in the areas specifically cited in the audit finding.

FINDING

29. State Assessors Board Revenue

The Assessor Certification Division had not established satisfactory internal control over its administration of State Assessors Board revenue.

We identified the following weaknesses in the Assessor Certification Division's administration of Assessor Certification and Training Fund revenue:

- a. The Division recorded Fund revenue from fees in an inefficient manner, utilizing a manual system of handwritten ledgers to record transactions and to

account for fees. Updating its manual ledgers to an automated system would provide the Division with a more efficient and accurate system for recording transactions and accounting for fees.

- b. The Division did not reconcile its manual subsidiary records of Fund revenue with revenue recorded in the State's accounting system. A comparison of the balances contained in the State's accounting system to the Division's subsidiary records for four months in fiscal year 2001-02 disclosed that the Fund's fund balance recorded in the State's accounting system exceeded the balance recorded in the Division's subsidiary records by \$3,025.

Periodic reconciliation of revenue recorded in the State's accounting system with the Division's subsidiary records would help ensure that revenue is accurately deposited and recorded, Division subsidiary records accurately reflect payments credited to the Fund, and accounts are properly credited for payment.

- c. The Division did not account for all revenue received and recorded in the State's accounting system. We identified five accounting entries, representing 106 deposits totaling \$7,257, that were not accounted for in the Division's subsidiary records.

The Division should account for all revenue posted to the Fund to ensure that accounts are properly credited and that financial statements are fairly presented.

- d. The Division did not report Fund revenue to the State Assessors Board using the balances shown in the State's accounting system. The Division reported the balances contained in its manual, handwritten ledgers. Those balances had not been reconciled to the State's accounting system, did not agree with the balances contained in the State's accounting system, and did not reflect the balances deposited in the Fund by the Receipts Processing Division on the State Assessors Board's behalf.

Reporting revenues based on the balances shown in the State's accounting system ensures that the State Assessors Board has provided an accurate accounting of the funds deposited and available from the Fund.

RECOMMENDATION

We recommend that the Assessor Certification Division improve its internal control over its administration of State Assessors Board revenue.

AGENCY PRELIMINARY RESPONSE

The Bureau agrees with this finding and stated that it has developed a system to remedy it.

Glossary of Acronyms and Terms

ad valorem	A method of imposing tax based upon value.
capture	Process of taking that portion of ad valorem property tax revenues associated with the incremental increase in property values from the State, school districts, and local units of government and shifting those revenues to TIFAs, DDAs, and LDFAs to finance public improvements in designated areas.
chargeback audit	An audit of a local unit of government performed by the Local Audit and Finance Division at the request of the local unit of government and billed at a rate sufficient to support the cost of providing the audit.
commercial forest tax	A tax paid in lieu of general property tax on land designated as a commercial forest under the Natural Resources and Environmental Protection Act to the credit of the School Aid Fund.
DDA	downtown development authority.
DNR	Department of Natural Resources.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
foreclosure	A process by which the property owner is divested of title to tax delinquent property, unless property is redeemed through payment of tax due, and vesting of absolute title in the State or the county for ultimate disposition by sale.

forfeiture	A process in which the legal status of tax delinquent property is altered in order to permit foreclosure.
General Property Tax Act	An act providing for the levy, collection, and administration of ad valorem tax on property.
goals	The agency's intended outcomes or impacts for a program to accomplish its mission.
homestead	A dwelling or a unit in a multiple-unit dwelling owned and occupied as a home by the owner thereof, including all contiguous unoccupied real property owned by the person.
industrial facility tax	The tax paid in lieu of general property tax to a local unit of government by a business that has been granted a tax exemption for restoring, replacing, or constructing an industrial facility. The local unit is required to remit the school districts' portion of the tax to the Department of Treasury to the credit of the School Aid Fund.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
iron ore tax	A tax paid in lieu of general property tax on low grade iron ore mining property to the credit of the School Aid Fund.
LDFA	local development financing authority.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could affect the judgment of an interested person concerning the effectiveness and efficiency of the program.

mission	The agency's main purpose or the reason that the agency was established.
objectives	Specific outcomes that a program seeks to achieve its goals.
outcomes	The actual impacts of the program.
outputs	The products or services produced by the program.
pari-mutuel wagering	System of wagering used at horse racetracks to distribute gambling proceeds to winning bettors, racetrack operators, and the State.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
performance standard	A desired level of output or outcome.
private forest tax	A tax paid in lieu of general property tax on land designated as a private forest reservation under the Natural Resources and Environmental Protection Act to the credit of the School Aid Fund.
real estate transfer tax (RETT)	A tax on the value of real property transferred by contract for the sale or exchange of property or by deeds or instruments of conveyance of real property for consideration.
reconveyance	A process by which the property owner, subsequent to foreclosure and vesting of absolute title in the State or county, reclaims title by paying delinquent taxes, fees, penalties, and interest due.

redemption	A process by which the property owner, prior to foreclosure and vesting of absolute title in the State, county, or lien holder, reclaims title by paying delinquent taxes, fees, penalties, and interest due.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
reversion	A process by which delinquent property taxes are collected or, in lieu of collection, a process by which an owner of tax delinquent property is divested of title to the property due to nonpayment of taxes.
School Aid Fund	The fund established by Article IX, Section 11 of the State Constitution to be used exclusively for aid to school districts, higher education, and school employees' retirement systems, as provided by law.
special assessment	An assessment against real property calculated on a benefit or ad valorem basis for improvements such as curb, gutter, sidewalk, sewer, water, or street paving, whether a repair to an existing system or establishment of such where none exists.
Special Assessment Deferment Fund	The fund established to assist an owner of a homestead who is 65 years or older or who is totally and permanently disabled through long-term low interest loans.
State education tax (SET)	An ad valorem State tax levied upon real and personal property under the General Property Tax Act, the proceeds of which are required to be deposited to the credit of the School Aid Fund.

State housing development tax	A tax paid in lieu of general property tax on housing projects under the State Housing Development Authority Act to the credit of the School Aid Fund.
tax increment financing	A system of financing public improvements in designated areas by obtaining property tax revenue from incremental increases in property values within the designated area.
tax lien sales cancellation	A process of notifying tax lien holders, reimbursing a tax lien holder upon receipt of a tax sale certificate, billing counties for reimbursement, and receiving payment from counties when a tax sale is canceled. A sale may be canceled for various reasons, such as payment of taxes prior to the sale or an error in the description of the property.
TIFA	tax increment financing authority.
trailer coach park tax	A monthly tax on trailer coaches located in licensed trailer coach parks, paid in lieu of general ad valorem property tax to the credit of municipalities, counties, and the School Aid Fund.